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1969 - 70

THE SENATE OF CANADA

PROCEEDINGS OF THE STANDING SENATE COMMITTEE ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 1 - 16

WEDNESDAY, NOVEMBER 19th, 1969

Complete Proceedings on Bills S-2, S-6, S-7, S-8, and S-9,
intituled respectively:

"An Act to amend the Quebec Savings Banks Act";
"An Act to amend the Canadian and British Insurance Companies Act and other statutory provisions related to the subject matter of certain of those amendments";
"An Act to amend the Foreign Insurance Companies Act";
"An Act to amend the Trust Companies Act"; and
"An Act to amend the Loan Companies Act".

WITNESSES:

W. E. Scott, Inspector General of Banks.
R. Humphrys, Superintendent of Insurance.

REPORTS OF THE COMMITTEE

21217—1

THE STANDING SENATE COMMITTEE ON

BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aird	Croll	Leonard
Aseltine	Desruisseaux	Macnaughton
Beaubien	Gélinas	Molson
Benidickson	Giguère	Phillips (*Rigaud*)
Blois	Haig	Savoie
Burchill	Hayden	Walker
Carter	Hollett	Welch
Choquette	Isnor	White
Connolly (*Ottawa West*)	Kinley	Willis—(29)
Cook	Lang	

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, October 29, 1969:

Pursuant to the Order of the Day, the Honourable Senator Gélinas moved, seconded by the Honourable Senator Bourque, that the Bill S-2, intituled: "An Act to amend the Quebec Savings Banks Act", be read the second time.

After debate, and—
The question being put on the motion it was—
Resolved in the affirmative.

The Bill was then read the second time.

The Honourable Senator Gélinas moved, seconded by the Honourable Senator Bourque, that the Bill be referred to the Standing Senate Committee on Banking, Trade and Commerce.

The question being put on the motion it was—
Resolved in the affirmative.

Extract from the Minutes of the Proceedings of the Senate, November 4, 1969:

Pursuant to the Order of the Day, the Honourable Senator Denis, P.C., moved, seconded by the Honourable Senator Fournier (*de Lanaudière*), that the Bill S-9, intituled: "An Act to amend the Loan Companies Act", be read the second time.

After debate, and—
The question being put on the motion it was—
Resolved in the affirmative.

The Bill was then read the second time.
The Honourable Senator Denis, P.C., moved, seconded by the Honourable Senator Fournier (*de Lanaudière*), that the Bill be referred to the Standing Committee on Banking, Trade and Commerce.

The question being put on the motion it was—
Resolved in the affirmative.

Extracts from the Minutes of the Proceedings of the Senate, November 18, 1969:

With leave of the Senate,
The Order of the Day for the second reading of the Bill S-8, intituled: "An Act to amend the Trust Companies Act", was brought forward.

Pursuant to the Order of the Day, the Honourable Senator Connolly, P.C., moved, seconded by the Honourable Senator Lamontagne, P.C., that the Bill S-8, intituled: "An Act to amend the Trust Companies", be read the second time.

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After debate, and—
The question being put on the motion it was—
Resolved in the affirmative.

The Bill was then read the second time.

The Honourable Senator Connolly, P.C., moved, seconded by the Honourable Senator Benidickson, P.C., that the Bill be referred to the Standing Senate Committee on Banking, Trade and Commerce.

The question being put on the motion it was—
Resolved in the affirmative.

Pursuant to the Order of the Day, the Honourable Senator Lang moved, seconded by the Honourable Senator Burchill, that the Bill S-6, intituled: "An Act to amend the Canadian and British Insurance Companies Act and other statutory provisions related to the subject matter of certain of those amendments", be read the second time.

After debate, and—
The question being put on the motion it was—
Resolved in the affirmative.

The Bill was then read the second time.

The Honourable Senator Lang moved, seconded by the Honourable Senator Burchill, that the Bill be referred to the Standing Senate Committee on Banking, Trade and Commerce.

The question being put on the motion, it was—
Resolved in the affirmative.

Pursuant to the Order of the Day, the Honourable Senator Lang moved, seconded by the Honourable Senator Burchill, that the Bill S-7, intituled: "An Act to amend the Foreign Insurance Companies Act", be read the second time.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative.

The Bill was then read the second time.

The Honourable Senator Lang moved, seconded by the Honourable Senator Burchill, that the Bill be referred to the Standing Senate Committee on Banking, Trade and Commerce.

The question being put on the motion, it was—
Resolved in the affirmative.

ROBERT FORTIER,
Clerk of the Senate.

MINUTES OF PROCEEDINGS

WEDNESDAY, November 19th, 1969.

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m.

Present: The Honourable Senators Hayden (Chairman), Beaubien, Benidickson, Blois, Burchill, Carter, Connolly (Ottawa West), Desruisseaux, Gelinas, Haig, Hollett, Kinley, Phillips (Rigaud) and Welch. (14)

Present, but not of the Committee: The Honourable Senator Gouin.

In attendance: E. Russell Hopkins, Law Clerk and Parliamentary Counsel.

The following Bills were examined:

Bill S-2, "An Act to amend the Quebec Savings Banks Act."

Witness: W. E. Scott, Inspector General of Banks. After discussion and upon motion it was *Resolved* to report the said Bill without amendment.

Bill S-9, "An Act to amend the Loan Companies Act."

Witness: R. Humphrys, Superintendent of Insurance. After discussion and upon motion it was *Resolved* to report the said Bill without amendment.

Bill S-8, "An Act to amend the Trust Companies Act."

Mr. Humphrys again appeared. After discussion and upon motion it was *Resolved* to report the said Bill without amendment.

Bill S-6, "An Act to amend the Canadian and British Insurance Companies Act and other statutory provisions related to the subject matter of certain of those amendments."

Mr. Humphrys again appeared. After discussion and upon motion it was *Resolved* to report the said Bill without amendment.

Bill S-7, "An Act to amend the Foreign Insurance Companies Act."

Mr. Humphrys again appeared. After discussion and upon motion it was *Resolved* to report the said Bill without amendment.

At 10:25 a.m. the Committee adjourned to the call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

REPORT OF THE COMMITTEE

WEDNESDAY, November 19th, 1969.

The Standing Senate Committee on Banking, Trade and Commerce to which was referred the Bill S-2, intituled: "An Act to amend the Quebec Savings Banks Act", has in obedience to the order of reference of October 29th, 1969, examined the said Bill and now reports the same without amendment.

Respectfully submitted.

SALTER A. HAYDEN,
Chairman.

WEDNESDAY, November 19th, 1969.

The Standing Senate Committee on Banking, Trade and Commerce to which was referred the Bill S-9, intituled: "An Act to amend the Loan Companies Act", has in obedience to the order of reference of November 4th, 1969, examined the said Bill and now reports the same without amendment.

Respectfully submitted.

SALTER A. HAYDEN,
Chairman.

WEDNESDAY, November 19th, 1969.

The Standing Senate Committee on Banking, Trade and Commerce to which was referred the Bill S-8, intituled: "An Act to amend the Trust Companies Act", has in obedience to the order of reference of November 18th, 1969, examined the said Bill and now reports the same without amendment.

Respectfully submitted.

SALTER A. HAYDEN,
Chairman.

WEDNESDAY, November 19th, 1969.

The Standing Senate Committee on Banking, Trade and Commerce to which was referred the Bill S-6, intituled: "An Act to amend the Canadian and British Insurance Companies Act and other statutory provisions related to the subject matter of certain of those amendments", has in obedience to the order of reference of November 18th, 1969, examined the said Bill and now reports the same without amendment.

Respectfully submitted.

SALTER A. HAYDEN,
Chairman.

WEDNESDAY, November 19th, 1969.

The Standing Senate Committee on Banking, Trade and Commerce to which was referred the Bill S-7, intituled: "An Act to amend the Foreign Companies Act", has in obedience to the order of reference of November 18th, 1969, examined the said Bill and now reports the same without amendment.

Respectfully submitted.

SALTER A. HAYDEN,
Chairman.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Ottawa, Wednesday, November 19, 1969

The Standing Senate Committee on Banking, Trade and Commerce, to which were referred Bill S-2, to amend the Quebec Savings Banks Act; Bill S-8, to amend the Trust Companies Act; Bill S-9, to amend the Loan Companies Act; Bill S-6, to amend the Canadian and British Insurance Companies Act and other statutory provisions related to the subject matter of certain of those amendments; and Bill S-7, to amend the Foreign Insurance Companies Act, met this day at 9 a.m. to give consideration to the bills.

Senator Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: Honourable senators, we have a number of bills before us this morning, on which this is the second time round, because we dealt with them earlier. May we have the usual motion to print?

> Upon motion, it was *resolved* that a verbatim report be made of the proceedings and to recommend that 800 copies in English and 300 copies in French be printed.

The first bill we have to deal with is Bill S-2, to amend the Quebec Savings Banks Act. The Inspector General of Banks, Mr. Scott, is here to explain the purpose and intent of the bill.

Mr. W. E. Scott (Inspector General of Banks): Mr. Chairman, until very recently two banks have operated under the Quebec Savings Banks Act, la banque d'économie de Québec and the Montreal City and District Savings Bank, and the majority of the Province of Quebec has been divided between them. The Quebec bank operated in the defined District of Quebec, and the Montreal bank in the defined District of Montreal.

Earlier this year, Bill S-27 changed the status of the Quebec institution to that of a chartered bank. As a chartered bank it will, of course, be able to open branches anywhere in Canada or outside Canada if it wishes. In view of this, the Montreal City and District Savings Bank felt, and the minister agreed, that it would be reasonable to allow them to operate in the remaining part of Quebec, and that is the only purpose of this bill. They will be able to open branches, if they wish, in that part of Quebec that lies outside the present District of Montreal.

The Chairman: Any questions?

Senator Haig: I move that we report the bill without amendment.

Hon. Senators: Agreed.

(*The committee proceeded to the next order of business.*)

The Chairman: Honourable senators, we now deal with Bill S-8, to amend the Trust Companies Act. You will remember that we had this bill before us last year, when we conducted a hearing at which the trust companies representatives appeared and supported the amendments, which were, I suppose one would say, liberalizing the authority to the trust companies. I have a letter from the Trust Companies Association of Canada, addressed to me as chairman, in which they say:

> On October 29, I wrote to you concerning Bills S-8 and S-9 amending respectively the Trust Companies Act and the Loan Companies Act.
>
> That letter was addressed to you in Ottawa but, since some of our mail has been going astray, I was concerned as to whether or not you had received it. I am taking the precaution then of writing you again to say that it is our understanding that there are virtually no changes in these two bills and, as you know, we had no objections to them when we appeared before your committee earlier this year.
>
> Our main concern is that the bills become law as soon as possible.

We will therefore not look forward to hearing any representation by the Trust Companies Association of Canada on this bill, or on

Bill S-9, an act to amend the Loan Companies Act. However, we have Mr. Humphrys here to repeat the highlights of the bill in the form in which it was before us earlier this year, and also to tell us what the additional amendments are.

Mr. R. Humphrys, Superintendent of Insurance, Department of Insurance: Mr. Chairman and honourable senators, the purpose of this bill is to amend the Trust Companies Act, which is an act of general application to federally incorporated trust companies. At the present time there are nine federally incorporated trust companies. They do about one-third of the guaranteed trust business in the country. There are, of course, a large number of provincially incorporated trust companies and some of these are very large ones. As I said, the provincially incorporated companies do about two-thirds of the guaranteed trust business and the federal companies do about one-third.

This bill will apply only to the federally incorporated companies. The principal purposes are as follows, but not necessarily in order of importance. I will try to touch on the main provisions. First, I shall mention the proposed change in the method of incorporating trust companies and the method of amending existing charters. Up to the present time the only method of accomplishing these purposes was by a private act of Parliament. It is proposed in this bill to make available a letters patent system of incorporating trust companies and a letters patent system of amending existing charters, even if the existing charter is by a special act.

This proposal would also include one permitting letters patent to be granted that would continue a provincial company as a federally incorporated company. It would be a way of converting a provincially-incorporated company to federal status. This technique could be used, but it would depend upon appropriate authority given to the company by its home jurisdiction, that is by the province in which it was incorporated.

The Chairman: You mean something equivalent to a consent?

Mr. Humphrys: Yes, a consent. I think it probably would have to be legislative authority in the province to permit a change in the corporate status. We have had one or two examples of this before Parliament where a similar thing was effected by a private act.

The second important provision would be some expansion in the investment powers of trust companies. For the most part, the changes and expansion are intended to bring the investment powers of trust companies into line with those of insurance companies. They would, therefore, make amendments that were parallel to those made in the insurance companies acts in 1965. The principal points dealt with would be certain expansion in the power to invest in real estate for the production of income and expansion in the so-called basket provision where companies would have an area of discretion to invest at their own choice, apart from the prescribed investment classes in the act. It is proposed in that connection to permit a company to invest up to 7 per cent of its guaranteed trust funds and 7 per cent of its own funds in investments of it own choosing. This 7 per cent basket would be of the same size as was granted to the insurance companies in 1965.

The Chairman: It is a sum total of 7 per cent.

Mr. Humphrys: It is, yes, but not less than the present basket. Trust companies now have a basket of 15 per cent of their capital on surplus. They would have that or 7 per cent of their assets in the guaranteed trust fund and in the company funds, whichever gives them the larger basket.

Senator Connolly (Ottawa West): I am glad you mentioned that, because I did not mention it last night.

The Chairman: How did you miss that one, senator?

Senator Connolly (Ottawa West): I did not miss it; I had it in my notes, but I thought I was talking too long.

Mr. Humphrys: Another important change that is in the area of investment would be a change that would permit trust companies to own subsidiaries. It is proposed here to give them certain powers to own subsidiary trust companies in foreign jurisdictions and subsidiary companies that might be best described as mutual fund companies, if they want to operate a mutual fund outside the trust companies. There will also be a general power to enable them to own subsidiaries to carry on any business that is reasonably ancillary to the business of the trust companies, subject to the concurrence of the minister and also the power to own subsidiaries, to own and manage real estate. All of these

powers to own subsidiaries would be subject to terms and conditions that would be specified by the Governor in Council regulations.

The purpose of requesting the power to impose terms and conditions is to enable limitations to be put on the amount of funds that a company could invest in a subsidiary and also to attempt to lay down some rules as to what the subsidiary might be able to do. It was not desired to open the way to allow trust companies to do things indirectly through a subsidiary that they could not do otherwise.

The Chairman: You used the word "ancillary" there, indicating a limitation on the authority of a subsidiary of a trust company. Do you mean in the sense of whatever the object or function of the subsidiary was going to be, it would have to cover something that was necessarily incidental to the main purpose of the trust company?

Mr. Humphrys: We had not thought that the phrase "necessarily incidental" would be required. We thought that "reasonably ancillary" would be a phrase that would encompass in it any function that is part of the functions that are carried on by a trust company in its normal business or a function that is connected with that in any reasonable way. The phrase is a bit general, I admit, but it was intended to convey power to own subsidiaries that would enable the trust company to carry on certain existing functions through subsidiaries and also functions that are related to the kind of business it is now doing. The phrase is intended to be restrictive enough to give the minister some guidance in what he should approve or disapprove in applications by companies to own subsidiaries.

It is also intended to make clear that it is not directed, or not proposed, to allow trust companies into unlimited fields of activity that have no real relationship to the normal operations of the trust company.

The Chairman: Those objectives would have to be pretty specifically drawn in the principal company, would they not?

Mr. Humphrys: The powers of a trust company, of course, are specified in the general Act.

The Chairman: You might have to consider exclusions as well.

Mr. Humphrys: In the terms and conditions application to investment in a subsidiary company, there may well be provisions that would require a subsidiary to give an undertaking that it would confine its activities to certain specified activities, so that it would not create a channel whereby a trust company could engage in a wide variety of functions that have no relationship to its essential purpose and its normal business.

The Chairman: You have got to be sure of that. Otherwise, you are really opening a door.

Mr. Humphrys: The terms and conditions would have to be specific enough on that.

The Chairman: Right in the object.

Mr. Humphrys: It would not necessarily be in the objects, because the way is open in this provision for companies to own subsidiaries that are incorporated in foreign jurisdictions, so we might not have the power to restrict the objects of the subsidiary in the charter that it is granted by the other jurisdiction. But we would propose in the terms and conditions to require undertakings from the subsidiary to confine itself within defined areas of activity in order to meet this objective.

The Chairman: You could always impose that condition, because you would have jurisdiction over the trust company.

Mr. Humphrys: Yes. And it is proposed here one of the changes we made in the bill as compared with the bill considered in the last session—is to make it clear that a trust company could be required to dispose of the shares in the subsidiary, if it did not comply with an undertaking it had given to confine its activities to those without; so we would have control in that direction. I admit that the term "reasonably ancillary" is a general term. We thought it, however, a term that would give some flexibility to permit the establishment of subsidiaries without really being so wide as to let a company go into a great many unrelated activities. We thought that some such phrase was necessary, to give the minister some guidance in principle as to what he should take into account in exercising his discretion as to whether to approve or not.

The Chairman: It would be an extension not intended if, for instance, a trust company proposed to own a professional hockey team as "reasonably ancillary"?

Mr. Humphrys: Oh, yes, senator, it would.

Senator Haig: Where would they get the franchise?

Senator Connolly (Ottawa West): Following the chairman's question, if you found that a trust company was to acquire a subsidiary in a foreign jurisdiction which had powers that were not ancillary, I take it that what you would say is that if it exercises those powers then it shall not own it?

Mr. Humphrys: What we would propose, senator, is that the trust company, as a condition of being permitted to make the investment in that subsidiary or own the subsidiary, would be required to file an undertaking from that subsidiary that...

Senator Connolly (Ottawa West): ...that it would not exercise...

Mr. Humphrys: ...that it would confine itself to certain activities.

Senator Connolly (Ottawa West): That it would not exercise those powers that were objectionable.

Mr. Humphrys: And the sanction would be that if the subsidiary failed to comply with its undertaking, then we would either tell the trust company we would disallow the shares as an asset of the trust company, or a more severe sanction would be to require the trust company to dispose of the shares of the subsidiary.

Senator Connolly (Ottawa West): Do you mind, Mr. Chairman, if I follow that along for a moment. It seems to me—and I am not being critical here—that perhaps you are taking a great onus on yourself to supervise the activity of a foreign subsidiary of a Canadian trust company in its activities.

Mr. Humphrys: We thought not, senator. We had not thought that this would place any responsibility on Canadian authorities to supervise the financial position of foreign subsidiaries. We would have to be informed of the activities of foreign subsidiaries, to know that any undertakings that were given by the subsidiary were being complied with, but the responsibility for the supervision and financial solvency would have to rest with its home jurisdiction.

In 1965, Parliament amended the Insurance Companies Act to give insurance companies broader powers than those they formerly had to own subsidiaries; and we used the same technique there, to impose terms and conditions and require undertakings from foreign subsidiaries. The technique seems to work out satisfactorily. We have had only two or three examples, but I believe it is a workable procedure.

We are proposing control also on the value at which the shares of the subsidiary company can be reflected in the balance sheet of the parent, so that if the subsidiary got itself into a very bad financial condition, the value of its shares, as they are shown in the balance sheet of the parent, would have to be adjusted downward, to reflect that; so that there is no risk in that sense to the policyholders of the Canadian company.

Senator Connolly (Ottawa West): Or the shareholders.

Mr. Humphrys: Or the depositors in the Canadian company. So I believe we have adequate safeguards to avoid risk to the creditors, and the depositors or the policyholders of the Canadian company, as a consequence of something disastrous that happens to a foreign subsidiary.

The Chairman: So the sanction of disallowance of the foreign asset as part of the assets of the trust company in Canada is a pretty tough sanction.

Mr. Humphrys: Yes, it is. We would ask the Governor in Council to propose limits on the total amount of money the Canadian company could pour into a subsidiary.

Senator Connolly (Ottawa West): I forget at the moment, but the main act gives you power to make regulations, does it not?

Mr. Humphrys: This proposal to expand the power of trust companies to own subsidiaries contains in the same clause the fact that such power would be subject to terms and conditions adopted by the Governor in Council.

Senator Connolly (Ottawa West): That is the regulatory aspect.

Mr. Humphrys: Yes.

Senator Phillips (Rigaud): Do we specifically prohibit guarantees to the foreign subsidiary in this bill?

Mr. Humphrys: It is not specifically prohibited in the bill, Senator. I do not think that the parent company would have that power in the absence of a specific grant ot it; if it did, we would really require the company to reflect that as a liability or a contingent liability in its balance sheet. We would not want a company to be committed, contingently or otherwise, beyond the limits that have been specified in the terms and conditions, because

it is important to protect the depositors and policyholders of the parent company.

I have expanded on this a little, Mr. Chairman, because the other bills that will be before you—relating to the Loan Companies Act and the Insurance Companies Act—also contain broader power to own subsidiaries, and this phrase "reasonably ancillary to the business of the main company" runs through them all.

I believe that, as we have all seen, the trend of affairs in financial institutions generally seems to be in the direction of broadening powers and more companies, are getting into a greater variety of activities. The neat divisions that we used to have years ago seem to be disappearing. This is being brought on, I think, even more rapidly by the trend towards holding companies and the bringing together in one holding company a complex or a variety of companies; and I think this step in the direction of broadening powers to own subsidiaries is probably consistent with that.

It may be that in the future it will go even farther and faster, but it had seemed to us that it was better to approach this step by step, even if one might feel that at some time even broader powers might be appropriate.

The Chairman: Mr. Humphrys, when you talk about a subsidiary, that implies, of course, that the trust company owns a majority of the shares—at least 51 per cent. Is that correlated in any way with the authority that is given to a trust company to invest within certain limits in shares of other companies?

Mr. Humphrys: Well, at the present time, as the act now is, there is a maximum limit on the proportion of stock of any corporation that may be owned by a trust company. It may not own more than 30 per cent of the stock of any other company. Well, this new power, which I have referred to as the power to own subsidiaries, is written in the bill as the power to make investments in certain types of companies beyond the limits otherwise specified; so this could be used to make any investments beyond 30 per cent, but the terms and conditions that were adopted in connection with insurance companies following the 1965 amendments required that a company own more than 50 per cent.

The view taken there was that, if it is purely for investment purposes, then 30 per cent is enough; but, if you want to go further, then you have to control it. The reasoning was that, if an insurance company or one of these companies under the pattern of supervision wants to go beyond the 30 per cent limit, then it should go far enough so that it controls the operation of the subsidiary and can require the subsidiary to conduct itself in a certain way, because that is relevant for the financial position of the parent.

Senator Burchill: Is there any limit to the amount that can be invested in foreign subsidiaries?

Mr. Humphrys: There are limits imposed on insurance companies by the terms and conditions adopted by the Treasury Board following the 1965 amendments, and we would propose that in the carrying out of these provisions, where the Governor in Council prescribes terms and conditions, he would put limitations on the total investment in the subsidiary, and these would be related to the capital and surplus of the parent company.

Senator Kinley: Mr. Chairman, I believe there is a national guarantee for trust companies of $20,000 for depositors. Does that guarantee apply to provincially incorporated companies as well as federally incorporated companies?

Mr. Humphrys: You are referring to the Canada Deposit Insurance Corporation, Senator, and the deposit insurance granted by the act applies compulsorily and automatically to all federally incorporated companies. It does not apply automatically and compulsorily to all provincially incorporated companies, but any provincial company may apply to the corporation for insurance coverage. At the present time, virtually all provincial trust companies accepting deposits have applied for insurance and are insured by the Canada Deposit Insurance Corporation.

The Chairman: It is a voluntary act on their part.

Mr. Humphrys: Yes, it is a voluntary act on the part of the provincial company. The province of Quebec has its own deposit insurance program, but of the companies incorporated in Quebec, those doing a deposit business outside Quebec have, in respect of their non-Quebec deposits, applied for insurance in the Canada Deposit Insurance Corporation and they are so insured. But the Canada Deposit Insurance Corporation does not insure the Quebec deposits of Quebec incorporated trust companies.

Senator Kinley: I also understand that each trust company has the same privilege of guaranteed investments.

Mr. Humphrys: If I understand you correctly, Senator, you are saying that, if a depositor had $20,000 deposited in each of two trust companies, both those deposits would be insured for the full amount of $20,000, and that is correct.

Senator Kinley: I just wanted to get that on record so that the man in the street would understand it.

Senator Connolly (Ottawa West): Mr. Humphrys, in the case of a provincially incorporated trust company, I take it that, if it does business outside the province, either it requires a licence or it is required to come in under this bill.

Mr. Humphrys: It depends on the views of the host province. A provincially incorporated company cannot go and do business in another province unless the other province permits it to do so. Now, it may permit it to do so by a licensing technique or a registration technique, but some provinces have required that, if a deposit taking institution from another province wishes to do business within their borders, then it must be insured under the Canada Deposit Insurance Corporation. This is not required by all provinces.

Senator Connolly (Ottawa West): The normal thing is for it to stay within its own province and operate in there.

Mr. Humphrys: No, I would not say that, senator, not in the trust company field. Some of our largest trust companies are provincially incorporated and they do business in a number of other provinces.

Senator Connolly: I am speaking particularly of some of the Quebec-based companies.

Mr. Humphrys: Some of the major ones are in the province of Ontario and some of them do business outside Ontario also.

The other main provision of this bill is a change in the system of supervision and control to improve the flexibility of control and give a better means of dealing with financial institutions or trust companies that get into financial difficulty. At the present time if a trust company gets into difficulty, the superintendent is required to report to the minister and the minister can impose certain conditions on it. It is proposed to retain that general concept but to expand the powers and make them more flexible. The superintendent would be required to report to the minister in any case where he thinks a company is getting into financial difficulty or where it has exceeded its borrowing limits, and the minister, if he concurs with the view of the superintendent, would have a number of powers open to him. He could impose conditions on the company or he could withdraw the certificate or he could require the superintendent to take over control of company's assets.

The Chairman: This is in line with the powers in the investment companies bill we have had before us.

Mr. Humphrys: Yes, and these powers appear in all other bills at the same time. If the superintendent has control of the assets of the company pursuant to the direction of the minister, he could apply to a court for authority to take over the management of the company or he could bring an application before a court to wind up the company. But the decision to take over the management of the company or to wind up the company would have to be by court order and would not be simply within the discretion of the superintendent or the minister.

There is also provision that if the superintendent has reason to believe that any assets are missing or are not properly accounted for, he can on his own decision take control of the assets of the company for a period up to seven days, and longer with the permission or concurrence of the minister. This is intended to give a quick power to freeze a situation until it can be investigated. I believe that these powers will give more flexible tools to deal with companies that are in difficulty and at the same time will permit steps to be taken to rehabilitate the company or resolve the difficulties without taking action so drastic as to alarm depositors and perhaps lead to the collapse of the company by the very effort of trying to rehabilitate it. This we considered to be a defect in the control provisions formerly existing. There was nothing much between persuasion and execution in the present rules.

The Chairman: Is there any correlation between the deposit corporation and the provincial authority? For instance, is there any correlation as to the kind of performance a provincial trust company must give, whether it must conform to federal supervision as well as to its own provincial supervision or is it still left free only to have to account to the provincial authority?

Mr. Humphrys: Under the Canadian Deposit Insurance Corporations Act, that corporation has the power to call for an annual examination of the provincial institutions that are insured by it. It can call for an examination by anybody of its own choosing. The practice to date has been that the corporation has called on the Department of Insurance to examine the provincial company on its behalf and we in turn have made arrangements with the provincial supervisors either to make the examination with our own staff or to make a joint examination with provincial staff or to obtain copies of examination reports as they are done by provincial examiners, and then we report in turn to the Deposit Insurance Corporation our judgment or assessment of the position of the company. The corporation has the power to terminate insurance if it believes that the company is insolvent or if it considers a company is not carrying out the business in accordance with sound financial and business practice. There is a procedure laid down in the act whereby it can notify the company, require the company to correct its defects and if satisfactory progress is not made, then it can as an ultimate step terminate the insurance. It should be clear, however, that the terminating of the insurance refers to future deposits. If insurance is terminated the contract requires that coverage continues for two years for existing deposits or until the maturity of any term instrument then existing. So that if insurance were terminated this would not mean that protection was withdrawn from people who had deposits at that time.

The other important feature I would draw your attention to is the borrowing limits prescribed for trust companies. At the present time a trust company cannot accept by way of deposit or by way of proceeds from guaranteed investment certificates more than fifteen times its capital and surplus. This bill proposes to raise it to twenty times subject to approval by the minister on application of the corporation.

Mr. Chairman and honourable senators, those are the highlights of the bill. There are a number of other amendments intended to change certain provisions relating to the internal corporate government and to effect a number of other changes of less importance that I could deal with in detail if you so wish, but I have outlined the main purpose and principles of the bill.

The Chairman: Shall we report the bill without amendment?

Hon. Senators: Agreed.

(The committee proceeded to the next order of business.)

The Chairman: Honourable senators, the next bill we have before us is Bill S-9 to amend the Loan Companies Act. Again you will recall that we had this bill before us in a previous session earlier this year. Mr. Humphrys was here at that time and gave an explanation of the amendments and representatives of the Loan Companies Association were here and expressed their agreement. In the letter I read to you earlier when we were considering Bill S-8 there was agreement on the part of the Trust Companies Association of Canada and also by the Loan Companies Association in relation to Bill S-9. In other words, they were satisfied with the amendments as proposed and in effect said "will you please hurry and get them into law."

Senator Connolly: They said that last spring.

The Chairman: That is right. Now, Mr. Humphrys.

Mr. Humphrys: Mr. Chairman and honourable senators, this bill, for the most part, parallels the bill to amend the Trust Companies Act. This act, the Loan Companies Act, applies to federally incorporated mortgage loan companies. There are 13 such mortgage loan companies now existing, and they have a very substantial amount of mortgage loan business. While they have fairly broad investment powers, their main purpose and main concentration of effort is in the mortgage lending field. 80 per cent of the assets are mortgage loans.

The main amendments are similar to those I have just described in relation to the Trust Companies Act.

There is an amendment dealing with the Letters Patent method of incorporation; an expansion of investment powers to bring them into line with those granted to insurance companies in 1965; and to give them a broader power to own subsidiaries. There is a change in the borrowing limit, from 15 to 20 times the capital surplus. There is a change in the method of supervision and control, which is parallel to the change I have just described for the Trust Companies Act.

There are two other points I think are worth mentioning, and these occur also in the Trust Companies bill. One is an expanded provision that attempts to prohibit investments and loans not at arm's length.

There are prohibitions in both these acts against loans to officers and directors and loans to corporations where officers and directors have majority control. It is proposed to expand that prohibition in an effort to eliminate other investments where there is a reasonable presumption that there may be a conflict of interest between the management, those making the investment decisions, and the company in which an investment is being made.

The Chairman: We are not defining a conflict of interest in this legislation?

Mr. Humphrys: No. I believe the provisions in here are defined, if not so extensively as to search out every possible situation of conflict of interest, than at least far enough to touch on the main areas where a conflict has occurred in the past and which are, I think, of a type where conflict may very well occur in the future. It is safer to rule out those particular types of investment.

The other point I would like to touch on is the liquidity reserve. In the Loan Companies Act now there is the requirement of a minimum liquidity reserve. That is, 20 per cent of deposits, an amount equal to 20 per cent of deposits must be held in assets in the form of provincial government bonds, federal government bonds, municipal bonds or cash.

It is proposed in this bill to change that liquidity base to require an amount equal to 20 per cent of deposits and the obligations coming due within 100 days if held in the form of federal and provincial bonds and cash and bank credit. At least one-quarter would have to be in cash and federal government bonds maturing in three years or less; at least one-half would have to be in the form of cash or federal governement bonds maturing in 10 years or less; the balance may be in federal or provincial bonds or bank credit or cash.

Senator Connolly (Ottawa West): How do you value these assets, at market prices at the time you are making the investigation?

Mr. Humphrys: When applying this test we use the value that is acceptable for statement purposes rather than the market value. To that extent the liquidity reserve, if you had to use it, may be less than 20 per cent of short-term securities, particularly in times such as at present where the market values are likely lower than the amortized values.

That is a point to be kept in mind, that the 20 per cent reserve is not as strong as it might otherwise be. However, it has been strengthened to some extent by requiring at least one-quarter of the reserves to be in cash or three-year federals. Federal bonds maturing within three years or less are not likely to be at as big a discount as the long-term. Another fraction would have to be in federal bonds maturing in 10 years or less. Again, you have some protection there.

The Chairman: Do you include in that Treasury bills?

Mr. Humphrys: Yes.

Senator Phillips (Rigaud): Did I understand you to say that liquid reserve includes bank credit?

Mr. Humphrys: Under defined conditions, yes.

Senator Phillips (Rigaud): How would the bank credit be calculated, in terms of lines of credit by a bank where money is lent at a particular moment?

Mr. Humphrys: The objective is to try to see to it that a company is in a satisfactory condition of liquidity.

Senator Phillips (Rigaud): Is that a new provision in the statute?

Mr. Humphrys: No, it is not a new provision in the Loan Companies Act; it has been in there, subject to conditions imposed by the Superintendent. If any company applied to have a line of bank credit taken into account in its liquidity test, we would have to impose conditions on it, and the main condition would be that the line of credit is a firm line and will stand for a definite period of time. So, you would have to be sure it would not disappear overnight.

The Chairman: And it could not be drawn on to that amount for any other purpose?

Mr. Humphrys: Yes, senator.

Senator Connolly (Ottawa West): It is an insurance policy then?

The Chairman: Yes.

Mr. Humphrys: Yes. It is important, I think, to recognize the possibility of using bank lines of credit if we put into the test of liquid reserve the maturing bonds coming due within 100 days, because if you have a debenture issue coming due in say 30 days you may not know how much you can roll over in the renewals, so a company might not wish to change the whole investment portfolio for

that uncertainty. However, it might get a stand-by line of credit, and then it might have to revise its investment portfolio in the light of actual experience.

In the Trust Companies Act there has not hitherto been a liquidity reserve requirement, although in practice the trust companies have kept a liquid reserve that was at least equal to that required in the Loan Companies Act.

This amendment would require a liquid reserve provision of the type I have just described and would be quite parallel to similar provisions in a number of provincial acts.

In the Loan Companies Act, municipal securities at present are acceptable as part of liquid reserve. It is proposed to drop that and restrict the liquid reserve to federal and provincial bonds, cash and bank credit under defined conditions.

Senator Phillips (Rigaud): That is a melancholy reflection on the condition of our economy, in part?

Mr. Humphrys: The point is not that the municipal securities are necessarily bad investments or would not pay at maturity, but they are not nearly as marketable as a class.

Senator Connolly (Ottawa West): I suppose they would be permissible investments.

Mr. Humphrys: Yes, it does not interfere at all with the power of the company to invest in them.

Senator Connolly (Ottawa West): In other words, municipalities would have access to the trust companies for the sale of their securities?

Mr. Humphrys: Yes, there is no question about that, senator.

The Chairman: In Bill S-9 have you struck out municipals as part of the liquidity?

Mr. Humphrys: Yes.

The Chairman: And you have also done that in relation to trust companies?

Mr. Humphrys: With respect to trust companies the new liquidity provision that is being proposed is in terms of federal and provincial government bonds and cash and bank credit.

The Chairman: What have you done in terms of the insurance companies?

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Mr. Humphrys: There is no definite liquidity provision applicable to insurance companies because these provisions relate to deposit activities and the uncertainty as to when demands would be made on the institution for the withdrawal of funds.

Senator Phillips (Rigaud): And in respect of guarantee deposits, as I understand it, you indicated that in the trust companies bill it is related to paid-in capital and surplus.

Mr. Humphrys: The total amount of money that they can accept in the guarantee trust fund is a multiple of the capital and surplus.

Senator Phillips (Rigaud): Yes.

The Chairman: Are there any other points?

Mr. Humphrys: No. I think, Mr. Chairman, those comments cover the highlights. As I mentioned in the case of the Trust Companies bill, there is a number of other provisions that are of importance to the companies. I think, however, I have touched on the main points of principle.

The Chairman: You have touched upon the main points of interest so far as the public interest is concerned?

Mr. Humphrys: Yes.

The Chairman: Are there any other questions?

Senator Phillips (Rigaud): I have just one question, Mr. Chairman. What are the major companies that will be affected by this Loan Companies bill?

The Chairman: Yes, tell us some of them. There are 13 here, I think.

Mr. Humphrys: The largest is Canada Permanent Mortgage Corporation and the Huron and Erie Mortgage Corporation. They are two very large companies. The next largest in terms of total liability to the public would be Kinross Mortgage Corporation, and then the Eastern Canada Savings and Loan Company.

The Chairman: Kinross is a company in respect of which a bill went through this house five or six years ago, or a little longer?

Mr. Humphrys: Yes. There is also the Nova Scotia Savings & Loan Company, Fidelity Mortgage and Savings, International Savings and Mortgage, and General Mortgage.

Senator Phillips (Rigaud): Thank you very much. I just wanted a general idea.

The Chairman: If there are no further questions, shall I report the bill without amendment?

Hon. Senators: Agreed.

(The committee proceeded to the next order of business.)

The Chairman: We have now to deal with two bills affecting insurance companies, and we will take Bill S-6 first. This is a bill to amend the Canadian and British Insurance Companies Act.

I should tell the committee that I have received a letter from The Canadian Life Insurance Association referring to Bills S-6 and S-7. It is addressed to me, and reads as follows:

> We have reviewed the above bills as introduced in the Senate on October 23. In particular, we have reviewed and have no objection whatsoever to the changes in the bills as compared with Bills S-35 and S-36 that were in the Senate in the spring.
>
> Our position, therefore, is that we have no objection to this proposed legislation and support it.
>
> In the circumstances, we had not planned to be present when the bills reach your committee but naturally we would be ready and willing to appear should the committee so desire.

That letter is signed by Mr. W. T. Morgan, the General Counsel for The Canadian Life Insurance Association.

Mr. Humphrys, would you now assume your usual role and deal with Bill S-6?

Mr. Humphrys: Mr. Chairman and honourable senators, this bill amends the Canadian and British Insurance Companies Act, which is an act that applies to federally incorporated insurance companies, and also to British insurance companies that are doing business in Canada.

I should make it clear that the portions of the act that apply to British companies are found in a separate part, and they are identical to the terms of the Foreign Insurance Companies Act, which is a separate act applying to the activities of foreign companies in Canada.

So far as Canadian companies are concerned, there are four main purposes. One is to adopt a Letters Patent system for the incorporation of insurance companies and the amendment of charters, which is parallel to the changes I mentioned in the Trust Companies Act and the Loan Companies Act.

Senator Haig: Mr. Chairman, what happens to an insurance company that is incorporated by a private act? Does it have to come back to Parliament for an amendment?

The Chairman: No.

Mr. Humphrys: No, senator. It is proposed in this bill that a Letters Patent system can be used to amend an existing act of incorporation of a company. Any such amemdment by Letters Patent would have to be within the confines of the general act, so that the Letters Patent system could not be used to amend the general legislation, but it could amend the company's private act of incorporation in any fashion that is still within the general ground rules, if I may use that term, prescribed by the general act.

There would be a proposed change in the system of control and supervision, which is along the lines that I described in respect of the other companies. There would be an expansion in the investment powers, particularly with relation to the ownership of subsidiaries, similar to that which I have described, permitting life insurance companies to own subsidiary mutual funds, and also to own other subsidiaries that are in a business that is reasonably ancillary to that of the main company.

Senator Connolly (Ottawa West): Like the trust companies?

Mr. Humphrys: Yes, the same thing. The prohibition against investments and loans that are not at arm's length would be expanded in the fashion described in the other bills.

The Chairman: Could a life company have a subsidiary outside of Canada which was engaged in a trust company business?

Mr. Humphrys: I think not, Mr. Chairman. In the department, in discussing the meaning of "reasonably ancillary," we have not thought that a trust business as such would be within the area of being within "reasonably ancillary" to the business of life insurance, whether in Canada or out of Canada.

The Chairman: I was just thinking that life insurance seems to be ancillary to estate planning, and trust companies come into that aspect of it, and there might be a correlation. So, you have to make up your mind whether you want it or not?

Mr. Humphrys: It is arguable, I suppose. One might also look at the other side, and say that since trust companies administer pension plans there is an argument that the issuance of life annuities is ancillary to that business.

The Chairman: Yes.

Mr. Humphrys: The term will receive, no doubt, a good deal of discussion as time goes on. There is control over it. Any such investment requires the approval of the minister. The minister must be satisfied and, indeed, the company itself must be satisfied that the subsidiary is carrying on a business that falls within those words in the statute. But, of course, if the minister feels, for one reason or another, that it is not in the public interest for the life insurance company or the trust company or whatever company it is, to own a subsidiary of that type, then it is within his authority to withhold his permission.

The Chairman: That is the check-rein on it?

Mr. Humphrys: Yes.

The Chairman: Whether it is good enough remains to be seen?

Mr. Humphrys: Yes. Similar legislation is appearing in the insurance laws of a number of the states, and some of them have adopted similar wording to "reasonably ancillary". Others have gone further and left it completely to the discretion of the commissioner. So, there is quite a variety of approaches at the present time.

Fire and casualty companies are now required to submit their statement on the basis of the value of all their assets at market values. It is proposed here to make some slight modification in that by permitting them to take the impact of a drop in market values in three stages rather than all at one stage. That will give them some relief for balance sheet purposes, but the minimum test under the act which requires a fire and casualty insurance company to have at all times assets at least 15 per cent in excess of its liabilities will still be imposed on a market value basis. We think that is good sense. That is really down to a minimum margin, and if a company could not recover from that and it had to be taken over and re-insure its business with some other company no one would pay any attention to the market value of the assets at that stage. We feel it is important to have a market value test as a minimum.

So far as the British companies are concerned, the amendments applicable to them will be, so far as possible, parallel to those for the Canadian companies. This legislation has always followed the general principle of trying to make conditions applicable to non-resident companies doing business in Canada as close as possible to those applicable to Canadian companies. We cannot, of course, in this legislation deal with corporate powers of the non-resident company, but the conditions governing its activities in Canada are, as far as possible, parallel to those applicable to Canadian companies. They are required to maintain assets in Canda at all times equal to their liabilities here, and those assets on a market value basis, but there is no requirement that they maintain any surplus margin over and above the equivalence of liabilities to assets.

The Chairman: Regardless of the powers or the objects which a British company carrying on life insurance business in Canada may have in its charter issued by its own home territory, when it is operating in Canada and conforming to your deposit requirements and all those things, it still, I take it, could not exercise any of those powers in Canada which are in excess of the powers which a Canadian life insurance company might have and exercise. Is that right?

Mr. Humphrys: That would not necessarily follow, Mr. Chairman. So far as its insurance business is concerned, it would be confined to classes of business for which it has been specifically registered. The assets deposited in Canada to cover its liabilities to the policyholders would have to be of the same type that are eligible for investment by a Canadian company. If that non-resident company had broader powers and wished to exercise those powers in Canada using for the purpose assets that it brought into Canada from its home operation, this legislation would not restrict it. I do not think that is an unreasonable pohition in the sense that there is probably no special reason why a company should be at a disadvantage in that respect by becoming registered under the insurance law to do insurance business in Canada. There are, for example, a number of foreign insurance companies that invest in Canada but do not do any insurance business here. Their investment powers would be found in their own charter and they would not be subject to any Canadian restrictions.

The Chairman: And they could have subsidiaries in Canada.

Mr. Humphrys: They might have subsidiaries, yes. I am not saying that this would make Canadian companies annoyed. I do not think it would be an important matter to the Canadian companies unless one were faced with the situation of a non-resident company being authorized to transact insurance in Canada then, using its broader powers, to own a variety of other subsidiaries which it used to enhance its competitive position in relation to its insurance activites. Then it might get a competitive advantage as compared to Canadian companies who perhaps did not have that kind of power. So far that situation has not existed because the companies that have been doing business here, those from the United States at least, hithero have not had powers of this type that are significantly different from those of Canadian companies.

The Chairman: It may become important at some time though.

Mr. Humphrys: British companies traditionally have had very broad powers, but they have not exercised them in Canada beyond insurance activities. This particular type of situation has not arisen except possibly in connection with the ownership of subsidiaries within the insurance field.

In the past foreign companies have had broader powers than Canadian companies to own subsidiary insurance companies. As a consequence of that some foreign companies have bought up some Canadian companies, but this ended in 1965 when Parliament put a restriction on the sale of shares to non-residents for life insurance companies.

Senator Connolly (Ottawa West): This may be a little off the track, but I would like to ask the superintendent in any event. What he is talking about in one respect at least is institutional investment in Canadian economic activity, for example by a British insurance company which is not going to do insurance business in Canada but is going to invest in some Canadian project.

Have there ever been cases where the type of investment that was made by the foreign institution was beyond the powers contained in its letters of incorporation, wherever they may originate, so as to invalidate the investment that was made?

Mr. Humphrys: I am not aware, Senator Connolly, of any case of that type having arisen. Traditionally the companies incorporated in the United States have had rather restricted investment powers and they have been generally narrower than the powers available to Canadian companies. Our permissive investments would be wider than those of United States companies at home. I am not aware of any case where they went beyond their own home authority in investing in Canada.

British companies traditionally have had very broad investment powers, so it would be unlikely that they have encountered a case where they exceeded their corporate powers.

Senator Connolly (Ottawa West): I am thinking specifically of cases where huge investments have been made from abroad for debt issues for pipelines in the petroleum industry, and even mining. Some of them have a considerable element of risk. I suppose it is a case of *caveat emptor*, to make sure in the first place that the call is there. I take it we have had no difficulty in that respect?

Mr. Humphrys: No, we have not encountered any problem of that type.

Senator Phillips (Rigaud): Is there any precedent within the realm of the type of companies we are discussing that come under your jurisdiction where British companies are associated, bunched, with Canadian companies in a Canadian statute? I do not seem to know of any instance other than insurance companies where we have an act that deals with Canadian companies and British companies. I am wondering whether this is due to historical circumstances or whether there is a particular reason for it.

Mr. Humphrys: It is the result of the history relating to insurance legislation. Years ago there was only one insurance act applying to insurance companies doing business in Canada, in which there was a part applicable to Canadian companies dealing with corporate affairs and another part dealing with eligible investments, registration and so on, applicable to them all. As a result of a series of constitutional disputes that arose in relation to insurance and Privy Council references, the last one occurring in 1931, the federal Insurance Act was declared *ultra vires* in certain sections, and new acts were adopted in 1932. At that time a great effort was made to base the federal legislation on sound constitutional grounds, one of which was the jurisdiction over aliens coming into Canada to do business. The Foreign Insurance Companies Act

was split off, because it was thought they could speak of aliens in terms of foreign companies but not in terms of British companies, because they were within the Empire and the term "aliens" did not apply. A new act was therefore adopted for foreign insurance companies. The corresponding rules applicable to British companies wre really allowed to remain in the Insurance Act, but the title was changed to make it clear that there was another act. That was the history.

Senator Phillips (Rigaud): It looks to me as if the Treaty of Westminster is not applicable to British insurance companies; it seems to be a legacy of prior days.

Mr. Humphrys: That is right. In fact, the rules applicable to non-resident companies, be they British or foreign, are identical. Legislatively it would be better to have one act for Canadian companies and another for non-Canadian companies, or one for them all having one part dealing with Canadian companies and another part with foreign companies.

Senator Phillips (Rigaud): I want to make it clear that personally I have strong support for British companies, and all that sort of thing, but it seems rather strange in this year, 1969, that we have a Canadian statute dealing with the subject matter in the form we have here.

Mr. Humphrys: We have looked at it from time to time. Anyone who was close enough to the constitutional disputes to be affected by them does not want to stir it up at all. Perhaps the next generation will have nerve enough to change it.

Senator Phillips (Rigaud): It is what one might call a fossilized aspect of prior activities.

Mr. Humphrys: That is right.

The Chairman: When looking at the names of statutes, we have the typical case, as you well know, in the income tax act that came in 1917 called the Income War Tax Act. It was 1949 before we got enough courage to change the name, and it seems to me that we changed about everything else.

Senator Connolly: Last night there was introduced into the Senate a bill dealing with the importation of infectious diseases into Canada.

Senator Burchill: Mr. Chairman, did I understand you to say that all the companies were satisfied with this?

The Chairman: Yes. Were there any other points you wished to raise, Mr. Humphrys?

Mr. Humphrys: Those are the main points.

The Chairman: Mr. Humphrys has touched on all the main points. If honourable senators wish to ask any questions, now is the time.

Senator Hollett: What is meant by the term "arm's length" in relation to this bill?

Mr. Humphrys: That phrase is not used in the bill. It was an allusion I made in my comments to try to explain its purposes. There is a clause in the bill that rules out certain investments. They are described, and the principle behind the description is that if persons making investment decisions for a company have another interest in the corporation in which an investment is being considered, that investment is prohibited for the insurance company if the officers, directors or major shareholders have more than a ten per cent interest in the other corporation.

The principle is that the officers, directors and major shareholders of the insurance company have an influence on the investment decisions of the insurance company. If they or any of them have a major interest in the other corporation, there may be a conflict of interest in their decision on how to use the assets of the company, so it may be that the investment would not be at arm's length, since the people making the decision would be, in a sense, on both sides of the transaction. That was the purpose of it.

The Chairman: Arm's length really means between strangers.

Mr. Humphrys: Yes, really a position where you can make a completely objective decision whether or not that investment is in the best interests of the institution whose funds you are dealing with.

Senator Carter: I have one question on the Small Businesses Loans Act. One new clause in the bill empowers insurance companies to make loans to small businesses, which apparently are guaranteed under the Small Businesses Loans Act. As I understand it, the Small Businesses Loans Act imposes certain conditions under which the loans can be made. Do those conditions apply to insurance companies if they make the loan?

Mr. Humphrys: Yes. There is a reference in all three acts to empower any one of those types of companies to make loans pursuant to the Small Businesses Loans Act. Any loans made pursuant to that act must be in accordance with the rules laid down in the Small Businesses Loans Act, and they are then to some extent guaranteed by the Government; that is, the lending institution can come back on the Government for some portion of its losses.

Senator Carter: I understand that if the company wants to take advantage of the Government guarantee it must comply with the Small Businesses Loans Act. Does it prohibit insurance companies from making a loan for, say, inventory, which is prohibited under the Small Businesses Loans Act? Under this clause, could an insurance company make such a loan on the understanding that the loan would be guaranteed?

Mr. Humphrys: Not under this clause. It would have to look elsewhere in its investment powers to see whether it had authority to make a loan of the type you describe. In fact, it would have such authority pursuant to the so-called basket provision where it has a certain area of discretion to make loans or investments that are not otherwise—-

The Chairman: There is no government to guarantee there.

Mr. Humphrys: No, but the clause you refer to is confined to loans that are made pursuant to the conditions of the Small Businesses Loans Act.

The Chairman: I have a motion to report Bill S-6 without amendment.

Hon. Senators: Agreed.

(*The committee proceeded to the next order of business.*)

The Chairman: The final bill to which reference has already been made is Bill S-7, an Act to amend the Foreign Insurance Companies Act. We have the letter which I read to you in connection with Bill S-6, which also refers to Bill S-7. In other words, the Canadian Life Insurance Association finds Bill S-7 to be satisfactory and they support it. Is there anything in Bill S-7 that differs from what you have told us about Bill S-6, Mr. Humphrys?

Mr. Humphrys: This bill would affect amendments to the Foreign Insurance Companies Act that are parallel to the amendments relating to British companies that are in the bill just considered. It had to be dealt with as a separate bill, as I just explained, regarding the foreign companies.

The Chairman: There is nothing new in this bill as against S-6.

Mr. Humphrys: No, sir.

The Chairman: Are there any questions? Shall we report the bill? We have a motion to report the bill without amendment.

Hon. Senators: Carried.

The Chairman: That is our work for today. I had hoped we might have had an item for which we could go into camera for awhile to discuss: what we are going to do with a certain document that was tabled yesterday. However, the motion referred to this committee has not yet been made, and therefore I do not see how we can deal with procedures or organizations or anything at this time. I wish the members of the committee would think about it and consider how we should equip ourselves in the way of legal and accounting and economic assistance for the consideration of that document.

Senator Hollett: It was tabled yesterday?

The Chairman: Yes. If there is no further business, the committee is adjourned.

The committee adjourned.

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Second Session—Twenty-eighth Parliament
1969

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE
ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 2

WEDNESDAY, NOVEMBER 26th, 1969

Complete Proceedings on Bills S-4, S-5, S-10 and S-11,
intituled respectively:
"An Act to amend the Yukon Placer Mining Act";
"An Act to amend the Oil and Gas Production and Conservation Act";
"An Act to incorporate Pitts Insurance Company"; and
"An Act to incorporate Pitts Life Insurance Company".

WITNESSES:

Department of Indian Affairs and Northern Development: A. D. Hunt, Acting Assistant Deputy Minister; Dr. H. W. Woodward, Chief, Oil and Mineral Division; *Department of Energy, Mines and Resources:* G. M. McNabb, Assistant Deputy Minister, Energy Development; Dr. D. G. Crosby, Chief, Resources Administration Division. R. Humphrys, Superintendent of Insurance; *Pitts Insurance Companies:* R. W. Trollope, President; R. W. McKimm, Parliamentary Agent.

REPORTS OF THE COMMITTEE

21219—1

THE STANDING SENATE COMMITTEE ON

BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aird	Croll	Leonard
Aseltine	Desruisseaux	Macnaughton
Beaubien	Gélinas	Molson
Benidickson	Giguère	Phillips (*Rigaud*)
Blois	Haig	Savoie
Burchill	Hayden	Walker
Carter	Hollett	Welch
Choquette	Isnor	White
Connolly (*Ottawa West*)	Kinley	Willis—(29)
Cook	Lang	

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extracts from the Minutes of the Proceedings of the Senate, November 20, 1969:

"Pursuant to the Order of the Day, the Honourable Senator Lang moved seconded by the Honourable Senator Cook, that the Bill S-10, intituled: "An Act to incorporate Pitts Insurance Company", be read the second time.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative.

The Bill was then read the second time.

The Honourable Senator Lang moved, seconded by the Honourable Senator Cook, that the Bill be referred to the Standing Senate Committee on Banking, Trade and Commerce.

The question being put on the motion, it was—
Resolved in the affirmative."

"Pursuant to the Order of the Day, the Honourable Senator Lang moved, seconded by the Honourable Senator Cook, that the Bill S-11, intituled: "An Act to incorporate Pitts Life Insurance Company", be read the second time.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative.

The Bill was then read the second time.

The Honourable Senator Lang moved, seconded by the Honourable Senator Cook, that the Bill be referred to the Standing Senate Committee on Banking, Trade and Commerce.

The question being put on the motion, it was—
Resolved in the affirmative."

Extracts from the Minutes of the Proceedings of the Senate, November 25, 1969:

"Pursuant to the Order of the Day, the Senate resumed the debate on the motion of the Honourable Senator Hays, P.C., seconded by the Honourable Senator Robichaud, P.C., for the second reading of the Bill S-5, intituled: "An Act to amend the Oil and Gas Production and Conservation Act".

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative.

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The Bill was then read the second time.

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois, that the Bill be referred to the Standing Senate Committee on Banking, Trade and Commerce.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

"The Order of the Day being read,
With leave of the Senate,
The Honourable Senator Macdonald (*Cape Breton*) resumed the debate on the motion of the Honourable Senator Benidickson, P.C., seconded by the Honourable Senator Burchill, for the second reading of the Bill S-4, intituled: "An Act to amend the Yukon Placer Mining Act".

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative.

The Bill was then read the second time.

The Honourable Senator Benidickson, P.C., moved, seconded by Honourable Senator Burchill, that the Bill be referred to the Standing Senate Committee on Banking, Trade and Commerce.

The question being put on the motion, it was—
Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

MINUTES OF PROCEEDINGS

WEDNESDAY, November 26, 1969.

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m.

Present: The Honourable Senators Hayden (*Chairman*), Aseltine, Beaubien, Burchill, Carter, Connolly (*Ottawa West*), Cook, Croll, Gelinas, Giguere, Hollett, Kinley, Leonard, Macnaughton, Molson and Savoie. (16)

In attendance: E. Russell Hopkins, Law Clerk and Parliamentary Counsel.

It was Agreed that 800 copies in English and 300 copies in French of these proceedings, be printed.

The following Bills were examined:

Bill S-5, "An Act to amend the Oil and Gas Production and Conservation Act."

Witnesses: *Dept. of Energy, Mines and Resources:*

G. M. McNabb, Assistant Deputy Minister, Energy Development.

Dr. D. G. Crosby, Chief, Resources Administration Division.

Upon motion it was Resolved to report the said Bill without amendment.

Bill S-10, "An Act to incorporate Pitts Insurance Company."

Bill S-11, "An Act to incorporate Pitts Life Insurance Company."

Witnesses: R. Humphrys, Superintendent of Insurance. R. W. McKimm, Parliamentary Agent. R. W. Trollope, President.

Upon motion it was Resolved to amend Bill S-10 as follows:

Page 3, Line 6. Strike out "five" and substitute therefor "one".

Upon motion it was Resolved to report Bill S-10 as amended.

Upon motion it was Resolved to report Bill S-11 without amendment.

Bill S-4, "An Act to amend the Yukon Placer Mining Act."

Witnesses: *Dept. of Indian Affairs and Northern Development:*

A. D. Hunt, Acting Assistant Deputy Minister. Dr. H. W. Woodward, Chief, Oil and Mineral Division.

Upon motion it was Resolved to report Bill S-4 without amendment.

The Committee then proceeded *in camera.*

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

REPORTS OF THE COMMITTEE

WEDNESDAY, November 26th, 1969.

The Standing Senate Committee on Banking, Trade and Commerce to which was referred the Bill S-4, intituled: "An Act to amend the Yukon Placer Mining Act", has in obedience to the order of reference of November 25th, 1969, examined the said Bill and now reports the same without amendment.

Respectfully submitted.

SALTER A. HAYDEN,
Chairman.

WEDNESDAY, November 26th, 1969.

The Standing Senate Committee on Banking, Trade and Commerce to which was referred the Bill S-5, intituled: "An Act to amend the Oil and Gas Production and Conservation Act", has in obedience to the order of reference of November 25th, 1969, examined the said Bill and now reports the same without amendment.

Respectfully submitted.

SALTER A. HAYDEN,
Chairman.

WEDNESDAY, November 26th, 1969.

The Standing Senate Committee on Banking, Trade and Commerce to which was referred the Bill S-10, intituled: "An Act to incorporate Pitts Insurance Company", has in obedience to the order of reference of November 20th, 1969, examined the said Bill and now reports the same with the following amendment: *Page 3, line 6*: Strike out "five" and substitute therefor "one".

Respectfully submitted.

SALTER A. HAYDEN,
Chairman.

WEDNESDAY, November 26th, 1969.

The Standing Senate Committee on Banking, Trade and Commerce to which was referred the Bill S-11, intituled: "An Act to incorporate Pitts Life Insurance Company", has in obedience to the order of reference of November 20th, 1969, examined the said Bill and now reports the same without amendment.

Respectfully submitted.

SALTER A. HAYDEN,
Chairman.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Ottawa, Wednesday, November 26, 1969

The Standing Senate Committee on Banking, Trade and Commerce, to which were referred Bill S-10, to incorporate Pitts Insurance Company; Bill S-11, to incorporate Pitts Life Insurance Company; Bill S-4, to amend the Yukon Placer Mining Act; Bill S-5, to amend the Oil and Gas Production and Conservation Act, met this day at 9 a.m. to give consideration to the bills.

Senator Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: Honourable senators, we have four bills this morning. My suggestion is that we commence with Bill S-5. May we have the usual motion to print?

Upon motion, it was *resolved* that a verbatim report be made of the proceedings and to recommend that 800 copies in English and 300 copies in French be printed.

The Chairman: Bill S-5 is a bill to amend the Oil and Gas Production and Conservation Act, which we enacted earlier this year as Bill S-29. We have with us two representatives from the Department of Energy, Mines and Resources, Mr. G. M. McNabb, Assistant Deputy Minister, Energy Development, and Dr. D. G. Crosby, Chief, Resources Administration Division.

Mr. McNabb will give an outline of the bill and will explain why he is back here with amendments so quickly after we passed Bill S-29 last year.

Mr. G. M. McNabb, Assistant Deputy Minister, Energy Development, Department of Energy, Mines and Resources: Thank you, Mr. Chairman. Honourable senators, it was in March last that the Senate considered and passed Bill S-29, the Oil and Gas Production and Conservation Act, which was given Royal Assent on June 27 of this year.

Bill S-29 provided statutory authority for the control of oil and gas operations on Canada Lands in the Yukon and the Northwest Territories. Bill S-29 was initiated at a time when all Canada Lands came under one department, the Department of Northern Affairs and National Resources. However, when this responsibility was divided in 1966, both new departments—Northern Development and Energy, Mines and Resources—worked closely together in the drafting of Bill S-29 so that the terms of that act could apply to both the resources of the north as well as to the resources of the osffhore areas.

Accordingly, the amendments which are incorporated in Bill S-5, which is before you now, are quite minimal. They relate, for the most part, solely to the division of administrative authority between the two departments.

The significant amendment you will find in clause 3, which sets out the area of application of the bill.

As the chairman has noted, it is rather strange to come back with an amendment to an act which was passed earlier in the same year. However, there is a reason for this. At the time that Bill S-29 was being put forward, the Department of Northern Development had an urgent and immediate need for legislative control over operations of new gas deposits in the Northwest Territories. They had an immediate need for this legislation. At that same time, however, our department had been working on the possibility of a solution of the offshore jurisdictional problems and an offer had been made to the provincial governments by the Prime Minister. There had not been time for the provinces to respond adequately to that offer and we felt it essential that there be time for the provinces to respond. There has now been such time and discussions are proceeding with the provinces.

In addition, we have worded section 3 of the amendment, Bill S-5, very carefully and, if the honourable senators would look at that

section on page 3 of the bill, particularly the paragraph at the end of section 3—

The Chairman: They need to read 3(c) together with that, do they not?

Mr. McNabb: Let me read it out, please:

"3. This Act applies in respect of oil and gas in any of the following areas, namely:

(a) the Yukon Territory or the Northwest Territories;

(b) those submarine areas adjacent to the coast of Canada to a water depth of two hundred meters or beyond that limit to where the depth of the superjacent waters admits of the exploitation of the natural resources of the seabed and subsoil thereof; and

(c) any lands that belong to Her Majesty in right of Canada or in respect of which Her Majesty in right of Canada has the right to dispose of or exploit the minerals therein;

but does not apply in respect of oil and gas in any such area if the area is within the geographical limits of, or if the administration of the oil and gas resources in the area has been transferred by law to, any of the ten provinces of Canada."

This means that no matter what solution comes out of the negotiations which are now going on with the provinces, this portion of section 3 will be applicable.

Senator Connolly (Ottawa West): Regardless, also, of what may come out of the court decisions respecting the rights of Canada.

Mr. McNabb: That is right, Senator. We are being very careful in the drafting of this legislation not to conflict with any solutions which may come from negotiations.

The Chairman: You would say that you have written out the possibility of conflict with the provinces?

Mr. McNabb: That has certainly been our intent, Mr. Chairman.

The Prime Minister's announcement last September on offshore mineral rights has given added impetus to exploration activity on the offshore. As of this October, permits have been issued for 262,318,000 acres off the east coast; almost 16 million acres in Hudson Bay and almost 126 million acres off the west coast, for a total permit area of over 403 million acres. This, by the way, is an area larger than the province of Ontario.

More important than the volume of permits itself is the actual exploration activity. You may be aware that a drilling program was recently completed by Shell Canada off the west coast, and Shell has now initiated what is expected to be a major drilling program off the east coast. There are other programs to follow as well. Moreoever, during the past summer a drill hole was sunk in the Hudson Bay.

This activity only serves to emphasize the need for the amendment which you have before you and which, if I may summarize, will provide the following: it will give authority for the Governor in Council to make regulations for the control and administration of all physical operations associated with the development, production, storing and other handling of oil and gas, including such matters as safety and pollution. It has requirements for the conservation of oil and gas and the prohibition of waste. It gives authority to require pooling and unitization under certain circumstances. Wide spacing of wells consistent with good engineering practice and early unitization of fields will be a key to assuring that production costs are kept to a minimum so as to help make the oil and gas produced competitive in world markets.

Senator Connolly (Ottawa West): Is that going to be done by regulation?

Mr. McNabb: That is going to be done by regulation, yes, sir.

The Chairman: Most of those things, Mr. McNabb, are covered by Bill S-29.

Mr. McNabb: That is right, Mr. Chairman, and I am emphasizing that this now extends them to the offshore.

The Chairman: Yes.

Mr. McNabb: It will give authority to the two ministers concerned and the designated officers of the Crown to carry into effect the requirements of the act by issuance of directives and orders and, finally, the establishment of a committee to be knows as the Oil and Gas Committee to advise ministers and to hear appeals from orders and directives.

Senator Croll: Is this a departmental committee?

Mr. McNabb: No, Senator, this is a committee set up as outlined in Bill S-29—a committee of five, of which three can be from the Public Service and two from outside the Public Service.

Senator Connolly (Ottawa West): Normally, you would look to the industry, or somebody familiar with the work of the industry for outside membership on that committee.

Mr. McNabb: Yes, there is a requirement that they must be knowledgeable, of course, in the oil and gas industry, but there is also a restriction that no member of the committee shall have a pecuniary interest of any description, directly or indirectly, in any property of oil or gas to which this act applies, or own shares in any company engaged in any phase of the oil or gas industry in Canada, in an amount in excess off 5 per cent of the issued shares thereof.

Senator Croll: Bill S-29 was proclaimed in June. Has that committee of five been appointed yet under the old act?

Mr. McNabb: I do not believe so.

Dr. D. G. Crosby, Chief, Resources Administration Division, Department of Energy, Mines and Resources: No, sir. This committee of five will be appointed by the Governor in Council, actually, upon suggestions made to him.

Senator Croll: Yes, but the act was proclaimed in June and I wondered if, since then, the committee had been appointed. What is your answer?

Dr. Crosby: No, sir.

Senator Connolly (Ottawa West): In other words, this would enable you to take people who have less than the maximum specified number of shares and who are perhaps retired but are still able to step in and help in a national situation like this. Is that correct?

Mr. McNabb: Yes, sir, definitely.

Senator Burchill: Mr. Chairman, did I understand the Deputy Minister to say that licences had already been issued in various areas belonging to the provinces, or at least areas under discussion or negotiation with the provinces now?

Mr. McNabb: Honourable senators, what have been issued are exploratory permits which permit the drilling on the offshore areas. We have been very careful in the issuance of these permits that we do not come within the resource administration lines which were announced by the Prime Minister last December in his offer to the provinces.

Senator Connolly (Ottawa West): Mr. McNabb, one of the problems I imagine you have would be with overlaps of permits. That is, permits issued by the provinces, especially for underwater areas, would overlap with permits issued by the federal authority. How, normally, would you resolve these overlaps? Would you do so by negotiation with the provinces?

Mr. McNabb: I should like to ask Dr. Crosby, who issues the permits, to reply.

Dr. Crosby: For the most part, sir, people who have permit coverage from the federal Government also have the same coverage from the appropriate provincial government. They have gone to both levels of authority. There are some areas, it is true, where there is a certain degree of overlapping or conflict, and this is inherent in the difficulties involved in the present situation, where two different levels of authority are issuing permits. There are many ways this can be resolved. Some can be resolved administratively; others may require something in excess of that, and we are exploring some of these avenues now.

Senator Connolly (Ottawa West): You may have to go to the courts in some cases, is that it?

Dr. Crosby: I do not think, sir, that this will necessarily become the case. We anticipate that agreements will be reached with the provinces and that these will be enshrined in legislation. As such, they will become the law of the land, of course, both provincially and federally.

Senator Connolly (Ottawa West): In legislation?

Dr. Crosby: Yes. If we are to finalize the Prime Minister's offer, it will be necessary to enact legislation. I should point out that I am no legal expert, sir, and, speaking completely as a layman, I am at your mercy.

Senator Connolly (Ottawa West): We are at yours, too.

Dr. Crosby: This legislation is commonly called legislation by reference. In other words, it is legislation on the part of both the provincial governments and the federal Government, in which case, in reaching that legislation, these problems you mentioned will be clarified. It cannot be a unilateral act.

Senator Connolly: I know the overlap does exist and I wonder how it is going to be resolved. You have a rather special case down on the east coast in respect of the islands of

St. Pierre and Miquelon and probably there will be some more in the north when you get close to Russian territory and the Asian continental shelf. I suppose the latter problem has not arisen yet but probably the former one has. Can you give us any information about the position with respect to the French claim which may exist in St. Pierre and Miquelon and I do not want a long dissertation on this.

Mr. McNabb: Well, one of the ways of resolving boundary disputes is to use the equidistance principle. The boundary is determined at all points where it is equidistant between two different countries. In the case of St. Pierre and Miquelon we feel that that is not applicable in view of the size of the islands involved. If it were applied it would encompass a vast portion of our continental shelf on the east coast. There have been negotiations going on with French in this matter but these have not been concluded.

Senator Connolly: I understood that these negotiations may turn on the terms of the original grant of these islands to France, that perhaps they were given for specific purposes but not necessarily for all purposes.

Mr. McNabb: I do not believe that has entered into the talks. Dr. Crosby has participated in these negotiations so he may have more information on that.

Dr. Crosby: Originally the islands were ceded to France for the purpose of sheltering French fishermen, but subsequently all rights to the islands were ceded to France by the Crown and at the present time there is no question of France's jurisdiction over the islands themselves. However, the islands are only 85 square miles in area and the area of the continental shelf that France is claiming as possibly appertaining to the islands is many times that; it is more in the order of 18,000 square miles. So, of course, this is completely unacceptable to the Canadian Government.

Senator Connolly: Would that be mainly on the Newfoundland side?

Mr. McNabb: South of the island for the most part.

Senator Macnaughton: May I interrupt for a moment to ask how long these negotiations have been going on?

Dr. Crosby: Actual discussions began in January, 1967. However, we were in consultation with French authorities as early as a year previous to that. But the actual across-the-table negotiations began in January, 1967.

Senator Connolly: Have there been permits issued by the federal Government for the various lands claimed by France?

Dr. Crosby: Yes, originally France issued a permit by decree to Petropar, a state-owned company, in October, 1966, just before the actual commencement of face-to-face negotiations. After the first round of discussions in Paris in January 1967, the Canadian Government decided it would be only correct to issue permits in this region and so permits were issued by the Canadian Government in February 1967.

Senator Connolly: Have any provinces, for example Newfoundland or any of the other provinces issued any permits?

Dr. Crosby: Newfoundland has issued a permit that partly overlaps the French permit. There are no other permits. Actually the Newfoundland permit is not a permit in the sense of being the type of permit we issue. It is a provisional permit. It is issued with the proviso that if and when regulations are promulgated by the Government of Newfoundland for this particular area—it is done by Order in Council—they are no more onerous than those issued by the federal Government of Canada.

Senator Connolly: So that a good deal will depend on the result of the negotiations you are having with France?

The Chairman: They haven't got the guns out yet.

Senator Connolly: I don't think there would be much need for those anyway.

I have one more question and it is this; I understand that there has been some dispute about the drilling for oil and gas by organizations that have been granted permits and have done exploratory work in the Strait of Georgia on the west coast. Mr. Davis, the Minister of Fisheries was concerned not so much about the exploratory work but, as I understand from a speech of his which I have read, he felt that the development work should not be done. I think what he is concerned about is pollution and the situation that developed in California at Santa Barbara where pipes were destroyed and a well ran out of control. Has that situation been resolved?

Mr. McNabb: Well, there has been actual drilling off the west coast but there has been no drillin gin the Strait of Georgia. The drilling done by Shell Canada has been mainly to the north. However, there has been some drilling south of Vancouver Island down towards the boundary between Canada and the United States, but there has been no drilling in the strait itself. There has been, as you say, exploratory seismic work which has been non-injurious to fish life. The company that was active there was, I believe, Gulf Oil, and they withheld their exploration until the fisheries people could look at the situation and they actually assisted the Department of Fisheries in their investigations. It is open to question, of course, as to whether or not the geological conditions in the strait would warrant any company coming in there and making the expenditures necessary for actually drilling. However, I believe, and I ask Dr. Crosby to correct me here if I am wrong, that this area is again within the resource administration lines which we have proposed to the provinces and if these are accepted, this would be under the administration of the province. Perhaps Dr. Crosby can elaborate further.

Senator Connolly: Perhaps I can finish by asking this; with the drilling facilities now available and the safeguards, is it the opinion of the federal authorities that it could be conducted without real danger or serious danger of pollution?

Mr. McNabb: Yes, sir, it is our feeling it can, with the proper regulations and enforcement of the regulations. It is done in many cases throughout the world. The Santa Barbara disaster has certainly brought the danger to the minds of everybody.

Senator Connolly (Ottawa West): I understood that was more of an accident than anything else, was it not?

The Chairman: No opinions!

Mr. McNabb: Let me say, senator, that, in administering the drilling operations that have been carried out off the west coast of Canada, we have been quite stringent in the amount of casing put down in the wells, because we feel that to a large extent we are dealing with strata there is not too much known about. In areas where we feel there are no pressures I believe the minimum casing we have permitted is in the area of 3,000 feet; and where we feel there are pressures it has been in the order of 6,000 feet. The amount of casing at Santa Barbara was, I think, in the vicinity of 300 feet. This gives some comparison.

Senator Connolly (Ottawa West): In any event, the responsibility is really going to be cast on the shoulders of the province in the Strait of Georgia?

Mr. McNabb: If the federal offer is accepted.

Senator Connolly (Ottawa West): Yes, if the federal offer is accepted.

Mr. McNabb: Yes, but Bill S-29 has specific powers in it concerning pollution and enforcement of measures to prevent pollution—not after the fact, but before the fact.

Senator Macnaughton: Continuing along the line of questioning of Senator Connolly, I understand our country has the second largest shoreline of any country in the world, after the U.S.S.R.

In clause 3 you speak of offshore installations, etcetera. Speaking of the continental shelf, have you any idea of how far out we could claim on the continental shelf? Is it 15 miles or three miles?

Mr. McNabb: Clause 3(b) of Bill S-5 reads:

> 3. This Act applies in respect of oil and gas in any of the following areas, namely:
>
> (b) those submarine areas adjacent to the coast of Canada to a water depth of two hundred meters

—which is 650 feet, approximately—

> or beyond that limit to where the depth of the superjacent waters admits of the exploitation of the natural resources of the seabed and subsoil thereof;

This wording is almost word-for-word from the Geneva Convention on the offshore.

Senator Carter: It seems to me there is an inconsistency there. In the first part you are very rigid, when you say, "to a water depth of two hundred meters". The depth of the ocean varies during the day and various seasons of the year. The depth might be 200 meters one day, but it might not be the next or another day. Then, when you get to the other part, you are very flexible as to where the waters admit of exploitation. Who determines that? Have they to prove it can be done, or have they got to go in and do it, or is it just somebody's opinion?

Mr. McNabb: This changes year by year, as technology develops. Until a few years ago we would not have thought of drilling in, say, 800 feet of water; yet drilling rigs that are now under construction in Halifax are being built, I believe, to operate in a depth of 800 feet. There has been drilling undertaken in extreme depths of ocean, scientific drilling in the Gulf of Mexico to depths of many thousands of feet. So, as technology develops the physical capability for a country to exploit moves out.

Senator Connolly (Ottawa West): What about the North Sea?

Mr. McNabb: The North Sea is not too deep. This is really one of the problems in the North Sea and is the cause of the severe weather they encounter.

Senator Carter: That was not my point. My point was, when you have a rigid line and a variable one, the two do not mesh.

The Chairman: Is it a rigid line? It is not, from the language as I read it.

Senator Carter: It says 200 meters.

The Chairman: It says:

> those submarine areas adjacent to the coast of Canada to a water depth of two hundred meters or
>
> —or—
>
> beyond that limit to where the depth of the superjacent waters admits of the exploitation of the natural resources...

It is 200 feet or any depth beyond that where you have rigs, etcetera, which will permit it.

Senator Carter: When you go beyond it the technology will change, but we are here considering jurisdiction and the issuing of permits. Which comes first? Do they have to prove they can go out there and do this?

Mr. McNabb: Dr. Crosby can elaborate on this.

Dr. Crosby: Perhaps I could first of all quote from the Geneva Convention on the Continental Shelf, because it was the intention of the drafters of this legislation to tie our domestic legislation in with the international legislation dealing with the same thing.

What we have done here is to tie this act into the Convention on the Continental Shelf, and the wording is deliberately used in that subsection to correspond almost exactly with the international terminology so there can be no doubt on the part of the international community as to what the intention of Canada is as regards claims to its offshore areas.

The Chairman: I think it might help if I framed the question Senator Carter was asking differently. Supposing I want to drill beyond the 200-meter depth and I have the rig and the facilities that will permit drilling in a depth of water greater than that. Where do I go to get my permit, and who gives me a permit which permits me to go beyond 200 meters in depth?

Dr. Crosby: We have already issued permits in water depths of up to 10,000 feet off the coast of Canada, and exploration work has been carried out off our coast in water depths up to and including 8,000 feet. Technology has gone ahead rapidly in recent years.

The Chairman: My point is, what authority have I behind a permit the Government of Canada may issue when I go out into that depth of water? Is that not free territory for any country?

Dr. Crosby: May I say a few words about our negotiations concerning Canada's claims to the offshore? We are now getting into the realm of international negotiations, and they have taken place, for the most part, at the United Nations. Canada is a member of the U.N. Committee on the Seabed. The position the Government of Canada has put forward is that the continental shelf and slope, which together comprise the continental terrace, are natural prolongations of the continent itself, and, as such, Canada claims sovereign rights for purposes of exploiting the natural resources of that region. We call that the submerged margin of Canada. We say that this is the natural prolongation of the dry land area, and so it naturally falls under the jurisdiction of the Government of Canada with respect to the natural resources of the sea bed.

Senator Macnaughton: For how many miles?

Dr. Crosby: In some cases this extends out as far as 400 miles east of Newfoundland, and about 170 miles southeast of Nova Scotia. These are the extreme limits.

The Chairman: This is a different principle from that which is involved in a discussion of surface rights?

Dr. Crosby: Absolutely, sir. We are not discussing the proprietary rights or the ownership at all, because most of these areas are beyond the territorial limits of Canada. We do not actually own the subsoil of the sea bed. All we have under international law is the sovereign right to explore the natural resources of the sea bed and the subsoil.

Senator Leonard: How far does that carry to the north?

Dr. Crosby: It has been estimated that between 500,000 and 600,000 square miles of off-shore area...

Senator Connolly (Ottawa West): That is the area.

Dr. Crosby: Yes, the total area.

Senator Connolly (Ottawa West): The senator asked you how far north it extends. What is the distance?

Senator Leonard: Does it extend as far as the North Pole?

Dr. Crosby: I do not know whether the North Pole itself would be on the continental shelf, but certainly the shelf itself extends for many miles.

Senator Hollett: I should like to ask who takes the responsibility for the welfare of the fishermen along that coast. I do not know how many miles long the coast is, but nine-tenths of the people who live along that coast depend solely upon the fishery. Suppose an ice floe breaks up and suddenly runs into one of these oil structures and demolishes it, who takes responsibility for the damage?

Dr. Crosby: In the first place, sir, the rigs and equipment used in the exploration phase of operations are all mobile, and they will actually have 48 hours notice, with the radar equipment, as to the approach of an iceberg. An iceberg travels at the rate of about half knot, and when they are warned of its approach they simply move. When we reach the production stage, which requires fixed, permanent installations, we will not be able, off the coast of Labrador, for example, to put in fixed production platforms that break the surface of the water because of the iceberg hazard there. If we did, then eventually one of them might become damaged. What will have to be done there is an extension of the technology that is now being developed for sub-sea installations. There will not be wellheads above the surface of the sea on permanent platforms. There will be wellheads that will be countersunk into the sea bottom.

Senator Hollett: But you have already granted them permits.

Dr. Crosby: Yes, sir, but these permits must be followed up at each subsequent stage of the exploration and development. No exploratory program can be carried out on the offshore without prior approval for each of these programs, and no well can be drilled without prior approval for each specific well.

Incidentally, I might mention that the Department of Fisheries, the Department of Transport, and the Dpeartment of National Defence, as well as ourselves, are all given prior notice of any off shore program. In the case of the Department of Fisheries it is 90 days' notice. In the case of the Department of Transport it is 90 days' notice. In the case of the Department of National Defence it is 45 days' notice. So, each of the departments with real, practical responsibilities for the offshore, the ones you are referring to, have prior notice of each and every program. If they wish to make suggestions as to whether a program shall be carried out or modified in some fashion, either as to timing or to area, it has the opportunity to do so. We have done this on occasion. In fact, we have done it in the Strait of Georgia.

Senator Hollett: This is a big responsibility. Who is going to take care of these people all along the coast of Newfoundland when there is pollution that kills all the fish. These fishermen have to live. Who takes responsibility for the welfare of these people. Is it the company which obtains the permit, or is it the department which grants the permit?

The Chairman: I would think it would be the department. The responsibility, I would say, is the responsibility of the department to enforce the regulations.

Senator Hollett: Does anybody know just how long it would take to clean up pollution from a fracture of an oil pipe?

Dr. Crosby: There have been accidents in many parts of the world, and we have learned from each of them. I think what we are trying to legislate here, sir, is authority to attempt to minimize or prevent any such accident. Once it has occurred, the plan for clean-up is quite another matter. This would be a national plan and, indeed, it is under preparation right now. There are plans for a national contingency program to take care of

disasters such as the one you are describing, but that is not covered by this legislation. This is legislation to prevent pollution from this one operation, namely, oil and gas drilling.

Mr. McNabb: I might say that the permits we have issued to date are exploration permits. There have been no actual leases of the off shore as yet.

Senator Hollett: I know, but when you are drilling down into the ground you might get a spurt of oil that you could not stop.

Mr. McNabb: Well, the regulations that we have now—and we hope to have better regulations under this legislation—we feel are adequate to prevent any possibility of that.

Senator Hollett: I hope the public will be properly informed as to what these regulations are, and what they will do for them.

The Chairman: If this legislation is properly administered, it will do the job. It depends upon the enforcement. What we are providing here is the authority. The department says it has learned from the experience in these operations in other parts of the world, and it thinks it can handle it.

Senator Hollett: A company threw some poison into Placentia Bay and killed every fish in it, and 300 fishermen lost their means of livelihood.

Senator Connolly (Ottawa West): Was that from a ship?

Senator Hollett: No, that was from a phosphate plant.

Senator Connolly (Ottawa West): I suppose that in the formulation of regulations the industry would be consulted? You work in collaboration with the industry, because they are the practical people, and they have to know what is required, and how to do it, and, of course, they have knowledge of the developing technology.

Mr. McNabb: Yes, senator, and they all are very much aware of the danger of pollution, and the consequences of an accident such as that at Santa Barbara.

Senator Molson: Just to bring the question of the continental shelf into focus I should like to cite as an example the Grand Banks. If a company wished to drill on the Grand Banks, would it get a permit from the Government of Canada?

Mr. McNabb: Yes, sir, it would, if that area, of course, was open for permit and was not already committed by permit.

Senator Molson: Yes, but the permit would be given by Canada?

Mr. McNabb: Yes.

Senator Molson: How far would that extend?

Mr. McNabb: Dr. Crosby has a map with him that shows the extent of permits already granted.

Senator Molson: As we were discussing this earlier at some length I would like to have the distances concerned in the case of the Grand Banks.

Mr. McNabb: I will distribute these maps, but the distances in question extend about 300 miles to the south of Newfoundland and about 400 miles to the east of Newfoundland.

Senator Hollett: That takes in the Grand Banks.

Senator Leonard: Mr. Chairman, what is the situation with respect to conflict of jurisdiction with the U.S.S.R.?

Mr. McNabb: I am not aware of any, sir. We have boundaries in four different areas with the United States, on the east and west coast, near the Queen Charlotte Islands where the Panhandle comes down, and between Alaska and the Northwest Territories. We have a boundary with Denmark between Baffin Island and Greenland and a boundary with France around St. Pierre and Miquelon, but I am not aware of any boundary which we may have in the north in common with Russia.

Senator Leonard: With the U.S.S.R.?

Mr. McNabb: No, it depends upon the solution which is found for the extension of the boundary between Alaska and the Northwest Territories. Conceivably, if some arrangement is worked out, we may have a common boundary in that area.

Senator Leonard: So there are no discussions taking place with the U.S.S.R.?

Senator Connolly (Ottawa West): How close does the land mass of the Asian U.S.S.R. come to the Canadian land mass? I just do not know my geography in that area; that is why I ask the question.

Mr. McNabb: I am not aware of the distance, sir.

Senator Connolly (Ottawa West): Would the median line rule that was established a couple of years ago apply there, or is it too great a distance?

Dr. Crosby: There are two different factors at least, and probably a great many more that come into play. One of them is...

Senator Connolly (Ottawa West): The continental shelf?

Dr. Crosby: Yes, the actual limits of any nation to its own off-shore areas. If Russia's continental shelf terminated before it joined that of Canada and it was decided by the international community that this was going to be the limits, that in itself would determine without discussion between the two nations exactly where the off-shore boundaries were. If, on the other hand, one did go to the median line, this would necessitate bilateral negotiations.

Senator Carter: The witness said that we have a boundary with France at St. Pierre and Miquelon. How is the boundary described?

Mr. McNabb: As Dr. Crosby mentioned, there are presently negotiations under way with France.

Senator Carter: Yes, as to the continental shelf.

Mr. McNabb: Yes, this is the extent of our respective jurisdictions on the continental shelf. We are trying to negotiate a settlement on that question.

Senator Carter: What is the actual boundary? I understood you to say that we have a boundary now.

The Chairman: No, we know the areas of the islands.

Mr. McNabb: We have a tentative boundary on our jurisdiction of the areas.

The Chairman: Shall we report the bill without amendment?

Hon. Senators: Agreed.

(*The committee proceeded to the next order of business.*)

The Chairman: Honourable senators, we will now deal with Bill S-10, and Bill S-11. We will have a report on these bills. Bill S-10 is an act to incorporate Pitts Insurance Company. We have Mr. Humphrys here to give us an explanation. The proposed companies are represented by their parliamentary agent, Mr. McKimm, a number of directors and officers of the company: Mr. Trollope, who is the president, Mr. Ingram, who is the comptroller and Mr. Lacey, who is director. Would you tell us first of all about Bill S-10, Mr. Humphrys, and your views on it?

Mr. R. Humphrys, Superintendent of Insurance, Department of Insurance: Mr. Chairman and honourable senators, the purpose of this bill is to incorporate a new general insurance company. Its form is in the standard form of bills for this purpose that have been before this committee many times in past years. One of the principal purposes of this bill incorporating a new federal company is to enable the new federal company to take over the business of an existing provincial company by the same name, the Pitts Insurance Company.

The Pitts Insurance Company was incorporated pursuant to the laws of Ontario in 1956 and has its head office in London, Ontario. The company is now relatively small. The premium income for the last year was about $1,100,000. The principal source of its business is from the membership of the Dominion Automobile Association. The company is controlled by the Dominion Automobile Association, which sells memberships to motorists throughout Canada. One of the privileges of membership is an accident insurance policy, which is underwritten by the Pitts Insurance Company.

This bill, if approved by Parliament, would create a new federal insurance company with power to take over by agreement the business of the provincial company. The company, if incorporated, would have all the standard powers of a fire and casualty insurance company in the form that has been granted to these companies in recent years. The company would be required to have capital of at least $1 million before it could commence business.

The Chairman: Mr. Humphrys, the requirement of capital to which you refer is in section 7.

Mr. Humphrys: Yes.

The Chairman: I understand there is a correction to be made in about the fifth line, where it says:

...a contribution to surplus of five hundred thousand dollars.

That should read one hundred thousand dollars.

Mr. Humphrys: That was the intention, Mr. Chairman, in discussions between the Department of Insurance and the persons seeking incorporation. It was agreed that the required capital would be $1 million and the initial surplus $100,000. It was a typographical error.

Senator Molson: Is that normal?

Mr. Humphrys: In the normal case, Senator Molson, the capital would be dependent upon the business that the company wanted to do. We might require higher capital and surplus if the company were starting afresh. Since this company is starting with an existing portfolio of business, we considered the $1 million capital plus $100,000 surplus would be sufficient capital in this case.

The Chairman: May I have a motion, then, to amend by striking out "five" where it occurs in section 7 and putting in "one"?

Senator Connolly (Ottawa West): I so move.

The Chairman: Is that agreed?

Hon. Senators: Agreed.

The Chairman: Is there anything further to add on this bill?

Mr. Humphrys: This bill, by the terms of section 9, provides that the act will not come into force until a notice to that effect has been published by the Superintendent of Insurance in the *Canada Gazette*. The purpose of that delay is to give time for the act, if it is passed by Parliament, to be approved by the members of the provincial company in time for an agreement to be worked out between the provincial company and the federal company, so that when the federal act is brought into force action will be taken at the same time that agreement between the federal and provincial companies becomes effective, so the provincial company will cease doing business and the federal company will continue.

Senator Connolly (Ottawa West): Perhaps I should ask this question of the principals rather than Mr. Humphrys. I suppose the company could accomplish the same purpose by getting licences from other provinces than Ontario and operating?

Mr. Humphrys: I would make this comment on that. The company does do business in more than one province, and has licences in other provinces, but it may not wish to enter all provinces. Perhaps Mr. McKimm or Mr. Trollope could make a further comment on that.

Mr. R. W. Trollope, President, Pitts Insurance Company: One of the problems is that perhaps the main purpose for being here and seeking federal incorporation is to enable us to go into the other provinces which now have restrictive legislation vis-à-vis the provincial company being granted a licence to enter their province. Manitoba is one where there are certain restrictions, Newfoundland is another, and Nova Scotia is another. The company has experienced considerable loss of business in not being able to do business in these provinces, and federal incorporation allows them to move throughout Canada and extend the impact of the company's business throughout the whole of Canada, and of course ultimately when business permits will allow us the opportunity of moving into the United States.

Senator Connolly (Ottawa West): The United States too?

Mr. Trollope: In probably three or four years, if business permits.

Senator Burchill: In making a change from the provincial to the federal, do you have to make any arrangements for permits with provincial governments?

Mr. Trollope: The arrangement would be a form of agreement with the provincial company and the sale of assets to the federal company after incorporation, which is subject to the approval of the department and the issuing of certificates. Then the federal company is entitled by law to operate throughout Canada.

Senator Burchill: With no reference to the provincial government?

Mr. Trollope: That is correct.

Senator Molson: This company has been operating for some time. Could we be told whether it has had underwriting profits, and what its financial condition is?

The Chairman: Perhaps Mr. Humphrys can give us the official word on that.

Mr. Humphrys: The operations of the company are quite small. As I said, the premium

income now is something over $1 million. The capital and surplus of the provincial company at the middle of this year amounted to about $580,000. The company has had modest underwriting profits. At the moment it is essentially a small operation, but it has been making small profits.

Senator Molson: Has it made any underwriting losses in the last five years?

Mr. Trollope: No, sir.

Mr. Humphrys: Mr. Trollope says they have not had underwriting losses in the past five years, and I should emphasize that its business is confined to personal accident and sickness insurance.

Senator Connolly (Ottawa West): Under the new amendment to the Canada Corporations Act, would it be necessary for this company to come here, or can it get these powers by letters patent?

The Chairman: You mean amendments to the Canadian and British Insurance Companies Act?

Senator Connolly (Ottawa West): The Canadian and British Insurance Companies Act.

The Chairman: No, it would not be necessary. Is that correct?

Mr. Humphrys: That is correct.

The Chairman: Are there any other questions? Perhaps we should give Mr. McKimm an opportunity to say something if he wants to.

Shall we report this bill with the one amendment?

Hon. Senators: Agreed.

[*The Committee proceeded to the next order of business.*]

The Chairman: Honourable senators we now deal with Bill S-11, to incorporate Pitts Life Insurance Company. Mr. Humphrys, what do you say on this bill?

Mr. Humphrys: Honourable senators, this bill can really be considered as a companion to Bill S-10. Its intention and purpose are the same as those I described for Bill S-10. However, this company would be formed as a life insurance company, and would have life insurance, personal accident insurance and sickness insurance. At the present time there is an existing company operating under the same name and under the same ownership as the Pitts Insurance Company. This life insurance company carries some of the personal accident and sickness insurance that arises from the Dominion automobile insurance transactions; it also has some other life insurance of a group basis, and a very small volume of individual policies.

Again the purpose is to form a federal company to take over the provincial company. The minimum capital and surplus required would be $500,000 capital and $500,000 surplus. The operation is quite a small one. The premium income was about $1.5 million, but this company has also been making modest profits. At the present time the operation is quite restricted, since it has nearly all its business from one source. If this incorporation is granted and the company decides to branch out, it would have to do so in a very tightly controlled way, so it would not be launching a pattern of expansion beyond its resources.

The Chairman: I notice that in section 5 provision is made for the amount of capital that should be subscribed, and also a contribution to surplus. The contribution to surplus in this bill is $500,000. Would you explain the difference between this and the previous bill?

Mr. Humphrys: Usually in the development of a life insurance company the strain on surplus is likely to be much greater in the case of a fire and casualty company, particularly with a specialized company such as the Pitts Insurance Company, which we just discussed. Consequently, it has generally been the practice to provide a larger amount of initial surplus in the case of life insurance companies so that this can be used to finance the growth of business before the company is in danger of impairing its capital. This has been the traditional reason for a large surplus in the case of life insurance operations.

You may wonder why the required capital is only $500,000, whereas the required capital in Bill S-10 was $1 million. We are here following the pattern we have followed in similar cases in the past. In the future, in accordance with bills that were just considered by the Senate, the initial capital for new life insurance companies will be raised to $200 million. However, in the case of companies already in existence, and particularly in a case such as this where it is really a question of transferring a company with provincial status into one with federal status, in the

context of a pattern of operation that is already known, we have felt that a lower requirement can be justified.

Senator Leonard: Is the present capital surplus of the provincial company, $500,000 paid up?

Mr. Humphrys: Yes, Senator Leonard, just slightly above that. The paid-up capital at the end of June was $502,500 and the surplus was $510,000.

Senator Leonard: Are these two provincial companies associated with any financial or investment groups other than the Dominion Automobile Association?

Mr. Humphrys: Not to my knowledge, senator. I would ask Mr. McKimm and Mr. Trollope to answer that.

Mr. McKimm: The answer is no.

The Chairman: Any other questions?

Senator Molson: With regard to the $510,000 surplus, was $500,000 of that paid in?

Mr. McKimm: Five hundred and two thousand dollars of capital and $500,000 surplus. I believe it is an accumulation of profits. Perhaps Mr. Trollope can deal with that.

Mr. Trollope: It is an accumulation of profits, sir.

The Chairman: Any other questions? Is there anything further that you might care to add before we deal with the third bill?

Mr. Trollope: Nothing further.

The Chairman: Shall I report the bill without amendment?

Hon. Senators: Agreed.

(*The committee proceeded to the next order of business.*)

The Chairman: The final bill to which we must give consideration is Bill S-4, to amend the Yukon Placer Mining Act. The witnesses are Mr. A. D. Hunt, Acting Assistant Deputy Minister of the Department of Indian Affairs and Northern Development, and Dr. H. W. Woodward, Chief of the Oil and Mineral Division of the same department. Mr. Hunt is going to carry the ball for the moment. Mr. Hunt, will you tell us what the bill proposes and why?

Mr. A. D. Hunt, Acting Assistant Deputy Minister, Department of Indian Affairs and Northern Development: Thank you, Mr. Chairman. Honourable senators, the purpose of the amendments in Bill S-4 is very simple. The Yukon Placer Mining Act is perhaps one of the oldest statutes on our books. It was first approved in 1906. Placer mining developed as an outgrowth of the Klondike Gold Rush in the Yukon. It was perhaps Canada's first large mining activity in the north. In placer mining the gravel of rivers and streams is excavated and washed, and the gold is sifted out. This type of mining is contrasted to what is known as hard rock mining whereby, either underground or in the open pit or quarry, the mineral is obtained by blasting the rock.

Senator Connolly (Ottawa West): We see this done in the television program "Bonanza".

Mr. Hunt: The Yukon Placer Mining Act was introduced many years ago when gold mining was about the only industrial activity in the Yukon, and little thought was given to using the land surface for anything but mining.

The act, as it presently exists, provides that any person staking a claim has full rights, not only to mining his claim to the surface, but the Government does not even have the power to set aside lands for a road, a right-of-way for a pipe line, an historic site or national park, or any other purpose.

The Chairman: You are talking about where there is water in the bed.

Mr. Hunt: The bed or the valley bottom of a river may not actually be covered with water. The term is rimrock. In any event, a placer miner can go in and stake the land and have absolute right to mine it. Should the Government, for public purposes, want to run a road through there or set aside the lands for a national park, as the Prime Minister announced just recently in the Dawson area, technically the Government would be unable to do so unless the miner were willing to release his land.

The purpose of this bill is simply to introduce amendments that would allow the Government to set aside lands for such purposes.

Senator Connolly (Ottawa West): Would this provision be retroactive?

Mr. Hunt: No, senator. Perhaps I should indicate that unfortunately placer mining in

the Yukon has really seen its heyday. The present population of Dawson City is about 500, whereas at the turn of the century it was some 25,000. The only company which continued to work the various creeks in the area, the Yukon Consolidated Gold Corporation, closed out its dredging operations at the end of 1966. Today only a few individuals stake claims and work them. We want to protect their right to do this, and I want to emphasize that granting the Government the right to withdraw land, as proposed here, would not to any extent inhibit their right to carry on their mining activities. In fact, section 48 of the Yukon Placer Mining Act still gives them the right to go on lands and to use the surface for their mining purposes. All that will happen here is that land can be set aside for some public purpose.

Senator Connolly (Ottawa West): Is production from this kind of mining substantial at all?

Dr. H. W. Woodward, Chief, Oil and Mineral Division, Department of Indian Affairs and Northern Development: The peak of placer gold production was 1901 to 1902 when about 1,500,000 ounces of gold were taken. This output decreased constantly with the passage of years, and around 1946 the dredging operations of Yukon Consolidated began to show a real decline. At one time the company had nine dredgers in operation. This had been reduced to about four in 1966, and then they shut down the operations entirely. At the terminal stage they were mining about 2 million cubic yards of gravel at about 36 cents; in other words, they were producing a little less than $1 million a year. It was actually an accretion of deposits that caused them to terminate operations. It cost them more to quarry and recover than they were getting in revenue.

Mr. Hunt: At the moment the value of gold production in the Yukon is only a few thousand dollars a year.

Senator Macnaughton: When the witness says that the Government may "set aside," does he mean by expropriation?

Mr. Hunt: No, sir. All surface land which has not been alienated by sale for housing or commercial development is still retained in the name of the Crown in right of Canada. Those are what are generally known in the north as vacant Crown lands. These are available to the placer prospector to go and stake. The procedure here would be where the Government felt that there would be a need for a road or some such thing, that these lands would be withdrawn from disposal, so that the placer miner could not go on those lands and stake them. In the case where claims are already in existence the Government would have to go to the prospector and purchase from him the right to go over his lands.

The Chairman: The general right of expropriation would exist.

Mr. Hunt: Yes.

Senator Burchill: Have there been occasions in the past where you needed authority you seek under this legislation?

Mr. Hunt: In the past, no, sir, not to any great extent. What has been happening is that there has been a tremendous upsurge of hard rock mining in the Yukon. The Yukon is expanding now very rapidly. People are moving into the territory. Expenditures are going up rapidly and the Government of course is increasing its investments in many areas. As my minister announced a couple of weeks ago, he intends to spend $2 million over five years, establishing national parks or historic sites in the Yukon. One of these would be an information centre on the lands at Bonanza Creek.

As the legislation stands at the moment, we could not actually withdraw that land at Bonanza Creek in order to have a small centre showing the history of placer mining in the area.

Another reason, which should be mentioned, is that some consideration has been given to the desirability of a national park. This is still under discussion with the people of the Yukon, and their views are divided on this. Should the Government decide that it appears desirable to establish a national park in the area, once again it could be done, but unless this amendment were approved, it would always be subject to the fact that a placer miner could actually go into the park and stake claims and work, which is of course contrary to the general thinking and purposes of a national park.

The Chairman: Should you have provided something more here, that is, that where placer mining claims have been staked and no operation has been carried out for five years or ten years, the title would revert?

Dr. Woodward: When a placer claim is granted there is a responsibility upon the

claim owner to perform $200 worth of work a year. And those claims are subject to renewal. As a consequence, those claims which have been held and are no longer worked are allowed to expire. There are only about 30 or 40 claims in existence, as compared with the peak of probably several hundred thousand in former days.

The Chairman: Then this is not an existing condition that you fear, but it is something that is going to give you more authority in the future?

Dr. Woodward: Yes.

Senator Molson: Is there a conflict in paragraph (b) of the proposed section 17, "used as a cemetery or burial ground"?

The Chairman: I do not know whether there is any gold in any of those places.

Senator Molson: I am wondering if anyone has ever staked a claim there, or tried to.

Senator Connolly (Ottawa West): I understand that when the St. Lawrence Seaway was being established the greatest bone of contention was the question of cemeteries. There was no trouble in moving a town but there was in moving a cemetery.

Mr. Hunt: I should mention that the exclusion of a cemetery has always been in the act, and, since we were revising that particular section, this provision has been repeated.

The Chairman: Are there any other questions? Shall I report the bill without amendment?

Hon. Senators: Agreed.

The committee went into *camera*.

Queen's Printer for Canada, Ottawa, 1969

Second Session—Twenty-eighth Parliament

1969

THE SENATE OF CANADA

PROCEEDINGS

OF THE

STANDING SENATE COMMITTEE

ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 3

WEDNESDAY, DECEMBER 3rd, 1969

Complete Proceedings on Bill C-140,

intituled:

"An Act to amend the Customs Tariff and to make a consequential amendment to the Excise Tax Act."

WITNESS:

Department of Finance: J. Loomer, Director, Tariffs, International Programmes Division.

REPORT OF THE COMMITTEE

21221-1

THE STANDING SENATE COMMITTEE ON
BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honorable Senators:

Aird
Aseltine
Beaubien
Benidickson
Blois
Burchill
Carter
Choquette
Connolly (*Ottawa West*)
Cook
Croll
Desruisseaux
Gélinas
Giguère
Haig
Hayden
Hollett
Isnor
Kinley
Lang
Leonard
Macnaughton
Molson
Phillips (*Rigaud*)
Savoie
Walker
Welch
White
Willis–(29)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDER OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, December 2, 1969:

"Pursuant to the Order of the Day, the Honourable Senator Hayden moved, seconded by the Honourable Senator Langlois, that the Bill C-140, intituled: "An Act to amend the Customs Tariff and to make a consequential amendment to the Excise Tax Act", be read the second time.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative.

The Bill was then read the second time.

The Honourable Senator Hayden moved, seconded by the Honourable Senator Langlois, that the Bill be referred to the Standing Senate Committee on Banking, Trade and Commerce.

The question being put on the motion, it was—
Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

21221—1½

MINUTES OF PROCEEDINGS

Wednesday, December 3, 1969.

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to examine:

Bill C-140, "An Act to amend the Customs Tariff and to make a consequential amendment to the Excise Tax Act."

Present: The Honourable Senators Hayden (Chairman), Aird, Aseltine, Beaubien, Benidickson, Carter, Connolly (Ottawa West), Cook, Croll, Desruisseaux, Flynn, Gelinas, Giguere, Haig, Hollett, Kinley, Leonard, Macnaughton, Molson, Phillips (Rigaud) and Welch. (21)

In attendance: E. Russell Hopkins, Law Clerk and Parliamentary Counsel.

It was *Agreed* that 800 copies in English and 300 copies in French of these proceedings be printed.

The following witness was heard:

Department of Finance:

J. Loomer, Director, Tariffs,
International Programmes Division.

Upon motion it was Resolved to report the said Bill without amendment.

At 9:40 a.m. the Committee proceeded *in camera.*

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Ottawa, Wednesday, December 3, 1969

The Standing Senate Committee on Banking, Trade and Commerce, to which was referred Bill C–140, to amend the Customs Tariff and to make a consequential amendment to the Excise Tax Act, met this day at 9 a.m. to give consideration to the bill.

Senator Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: Honourable senators, we have before us for consideration this morning Bill C–140, the Customs Tariff bill. Mr. J. Loomer, the Director of Tariffs in the Department of Finance, is here to carry the ball, ably assisted by Mr. J.W. Latimer and Mr. R. Catellier of the Tariffs Division. Mr. A.H. Halvorson, of the Customs Appraisal Division, Department of National Revenue, is also present.

There was a question asked yesterday in the house as to what countries were still subject to the general tariff. Mr. Loomer has given me a list of these general tariff countries, and they are as follows:

Afghanistan
Albania
Arabia (Yemen)
Bhutan
Caroline Islands
Eastern Germany
Jordan
Korea, North
Libya
Mongolian People's Republic
Nepal
New Hebrides
Rhodesia
Ryukyu Islands (including Okinawa)
Sikkim
Somalia, Republic of
Sudan, Republic of the
Tibet
Tripoli

Senator Leonard: What is the total volume of Canada's trade with those countries, expressed either in dollars or as a percentage of our total trade?

Mr. J. Loomer, Director of Tariffs, Department of Finance: I am sorry, but I do not have that figure. I expect it would be very small.

Senator Leonard: A fraction of 1 per cent, would it not be?

Mr. Loomer: I think that is probably correct; it is very small.

Senator Connolly (Ottawa West): If the tariff were easier on those countries, do you think the trade volume might be larger?

Mr. Loomer: I would not think so. In some cases the general tariff is the same as the Most-Favoured-Nation tariff, so there is no margin.

Senator Croll: Since most of the countries behind the iron curtain are not on that list–the only one I noted was East Germany–are there special problems there, or is there something special that keeps them out of the picture?

Mr. Loomer: I am not quite sure what the legal position is vis-à-vis East Germany as a country recognized by Canada.

Senator Croll: Oh, I see. I do not think it is recognized.

Mr. Loomer: No, I do not think it is.

Senator Croll: I had forgotten about that. I think that is the reason.

The Chairman: Another question which was asked was as to an estimate of the amount of revenue that might be lost by reason of the reductions in tariff that are implicit in this bill. I think Mr. Loomer estimates that for this year, which is really a nine-month period from June 4th, it would be around $50 million. For a full year I suppose it might be something of the nature of $60 million.

It is pretty hard to pick out any part of the bill and say it involves a particular principle, so, Mr. Loomer, we give you your head, to a great extent, subject to

questions that may be asked. Maybe the most interesting aspect would be the full implementation of the Kennedy Round. There is not any particular principle you can fasten on, so we will just take the bill section by section.

Senator Croll: What is the difference in respect of the tourists' allowances?

Mr. Loomer: The proposed new exemption for tourists is more generous. It will be $25.00 each quarter, rather than $25.00 each four months, and for the once a year trip there is a tourist exemption of $100 which applies to all countries, as opposed to the exemption of $75 which applies to countries beyond the limits of North America. That is a very simple explanation.

Senator Leonard: And accumulation of the $100 and the $25.00 is allowed?

Mr. Loomer: No, they cannot be taken together.

Senator Leonard: Not over a period of a year?

Mr. Loomer: Yes, but on separate trips.

Senator Leonard: So the maximum would be $175.00?

Mr. Loomer: No, $200.00.

The Chairman: Yes, you have to make a single trip for the $100.00, and then your other single trips would carry $25.00 each time.

Mr. Loomer: Yes, so there would be five trips.

Senator Carter: And then there are other trips for which there is an allowance of $5.00?

The Chairman: But you cannot enjoy the exemption of $5.00 if you are enjoying any of the others.

Senator Leonard: So it is on your sixth trip that you can have the $5.00?

The Chairman: Well, everything is relative, senator. Let us start with section 1.

Senator Desruisseaux: Before we commence, Mr. Chairman, I should like to know if Mr. Loomer is able to tell us whether the Kennedy Round agreements have brought about a favourable or unfavourable situation for us up to now, and, if so, to what extent?

The Chairman: This is a question that Mr. Loomer has noted, and it is posing problems for him. You will have to field it, Mr. Loomer.

Mr. Loomer: This is a very difficult thing to measure because you cannot isolate the Kennedy Round changes from other factors in the economy which can also affect trade. I would say that generally the Kennedy Round has worked out very well for Canada; that it has provided new export markets for Canada. Judging by the number of applications that have been made to the General Adjustment Assistance Board, it does not seem to have affected Canadian companies so adversely that there has been a general rush to apply for assistance. I do not think I can really go much beyond that, because this is only one factor, but an important factor, that affects trade. It is hard to sort of isolate this from other things which may be going on at the same time. My own view is that it has been very helpful to Canada.

Senator Desruisseaux: May I ask that question in reference particularly to textiles?

Mr. Loomer: In textiles the tariff changes were much smaller than they were in other areas, so the textile trade was not affected as much as other sectors of trade because the cuts were not as deep as they were in other parts.

Senator Gelinas: How about the fine paper industry?

Mr. Loomer: The cuts were somewhat deeper there. They did issue a press release when the Kennedy Round acceleration was announced. I do not think we have heard anything else since then, but certainly the cuts there were a little more substantial than in other parts. But, I understand that they are adjusting and making new plans to take account of the reductions in the Canadian tariff and the reductions in the American tariff where there fairly substantial reductions throughout the paper and wood fields.

The Chairman: Are there any other general questions?

Senator Molson: I should like to ask if Canada received any *quid pro quo* for the acceleration of the Kennedy Round reductions. They were put forward some two and a half years ago. What benefit did Canada receive for this acceleration on her part?

Mr. Loomer: This was a unilateral action on the part of Canada.

The Chairman: What Mr. Loomer is talking about now is the full implementation at this time. Is that your question?

Senator Molson: Yes.

Mr. Loomer: There was no serious negotiation to have other countries reduce their tariffs at the same

time. This was done unilaterally as a method of combating inflation.

Senator Leonard: Did it have anything to do with our balance of payments with the United States, with the intention of maintaining that balance within some limits?

Mr. Loomer: No, sir.

The Chairman: Are there any questions on section 1? You will recall that this is the section having to do with orders in council, and it amends the section in the act which provides that when an order in council is passed it really has a life of 180 days, and if it is not approved by Parliament in that time, if Parliament is sitting, then the order ceases to have any further force and effect. That was the original provision.

This amendment provides that if Parliament is not sitting at the time the 180th day has been reached, then the resolutions of both houses must be passed within 15 days after the commencement of the sitting of Parliament.

I made a comparison yesterday in the Senate with the situation we encountered in respect of the Hazardous Products Bill. In those circumstances we were giving the Government two years in which to come to Parliament and get an order approved, and they thought that that was not a long enough time, and that in addition it would clutter up Parliament. I am sure that there will be as many orders in council under the Customs Tariff as there will be under the Hazardous Products Act, but apparently the Government does not think that by enlarging the procedure by this bill that Parliament is going to be cluttered up.

I am sorry for taking over, Mr. Loomer. Section 2 deals with drawbacks?

Mr. Loomer: No, section 2 is really the same as section 1.

The Chairman: Yes. There was a question put yesterday as to whether there was any difference between the phrase "approved by Parliament," which is in the present section, and the phrase "resolution adopted by both Houses of Parliament." Mr. Loomer, what have you to say about that?

Mr. Loomer: It is my understanding that "approval by Parliament" means approval in the form of an Act of Parliament, rather than in the form of a resolution adopted by both houses.

The Chairman: That seems simple. What about section 3?

Mr. Loomer: This is just a technical change arising out of the new anti-dumping law.

The Chairman: Yes, there is no use calling it an anti-dumping tax when there are no more anti-dumping taxes.

Mr. Loomer: Yes.

The Chairman: Section 4?

Mr. Loomer: This is the section that brings into effect the remaining Kennedy Round reductions as of June 4.

The Chairman: This is on the point you were raising, Senator Molson. This changes the various dates on an instalment basis, and the rates will go down with one fell swoop as of June 4, 1969. Are there any further questions on that? If not, we will go on to section 5.

Mr. Loomer: Section 5 implements the Tariff Board's report on printing equipment, and proposes a new schedule of tariff items which reflect the Tariff Board's recommendations.

The Chairman: Are there any questions on this section?

Senator Carter: May I ask whether the word "machinery" here refers only to machinery required in the printing industry, or whether it would apply to other types of machinery?

Mr. Loomer: No, there are provisions in the Customs Tariff for other types of machinery.

Senator Leonard: Is there any difference between what is provided for here and what the Tariff Board recommended?

Mr. Loomer: Yes, there are some differences, senator. These are the more significant differences. It might be a little easier to follow if we refer to Schedule A. At page 9 of Schedule A, item 53415-1, the Board recommended rates of 10 per cent British Preferential Tariff, 15 per cent Most-Favoured-Nation for press blankets. It is proposed to retain the present rates, which are free British Preferential and 5 per cent Most-Favoured-Nation on press blankets or blanketing, of a class or kind not made in Canada.

The Chairman: The Tariff Board recommendation did not distinguish between a class or kind made in Canada and a class or kind not made in Canada, but the tariff change recognizes the difference.

Mr. Loomer: If we go back to page 8, this item has been reworded. The wording recommended by the Tariff Board . . .

The Chairman: Which item is that?

Mr. Loomer: Item 41210-1. The wording recommended by the Tariff Board for this item was broader than the range of such equipment that is made in Canada. Therefore this provides protection only on the equipment made in Canada.

On tariff item 41205-1 at the bottom of page 7 there has been a provision added for anti-offset spraying equipment. We had representations about this after the Tariff Board made its report.

Senator Leonard: I think those are enough examples, Mr. Chairman, to see what the significance of the changes is.

The Chairman: Where there are differences there seems to have been a reasonable explanation for the difference.

Senator Leonard: That is right.

The Chairman: Now we are at section 6, Mr. Loomer.

Mr. Loomer: Again this is from the Tariff Board's report on Reference 138 on certain precision instruments and apparatus used in engineering, surveying, prospecting, drafting and metal-working. The Tariff Board recommended modernization and expansion of the scope of certain of these items and some reductions in rates of duty.

The Chairman: Would you say that the language is more precise than rate of reduction?

Mr. Loomer: Yes.

Senator Carter: Do we have many "Most-Favoured-Nations," apart from the Commonwealth?

Mr. Loomer: The Commonwealth gets British Preferential. "Most-Favoured-Nation" would apply to just about everybody else, the United States, the Latin American countries, the European countries. They would all get Most-Favoured-Nation treatment.

The Chairman: Any other questions?

Section 7.

Mr. Loomer: Section 7 and Schedule C to the bill implement recommendations made by the Tariff Board in its report on Reference 134, equipment for hospitals and other institutions.

The Chairman: Is this a broadening of the item?

Mr. Loomer: It is a broadening, yes.

The Chairman: I think most of the items are duty free items?

Mr. Loomer: That is right.

The Chairman: Any questions?

Section 8.

Mr. Loomer: This is the usual miscellaneous group of tariff changes that appears in every budget. They arise out of representations from companies or associations.

The Chairman: Any questions?

Section 9.

Mr. Loomer: Sections 9 and 10 should be taken together. They are the new tourist exemption clauses.

The Chairman: We had some general questions at the beginning regarding that. Any further questions on the tourist exemptions?

We move on to section 11, which is consequential upon section3.

Mr. Loomer: Yes.

The Chairman: Section 12.

Mr. Loomer: This is an amendment to the Excise Tax Act which is consequential upon some of the changes which have been made in the Customs Tariff.

The Chairman: Yes. I think section 15 originally gave the authority for the instalment reductions in rates.

Section 13 is the excise.

Mr. Loomer: Yes. Section 14 is the one.

The Chairman: So section 14 is the coming into force.

Mr. Loomer: Yes. Section 14 provides authority for the coming into force.

The Chairman: But section 12 simply strikes out an existing section in the Customs Tariff because it is not needed.

Mr. Loomer: Yes.

The Chairman: Section 14 is the coming into force, which we dealt with yesterday. Any questions on it? Any general questions? I have one I want to ask Mr. Loomer in view of something that was said yesterday: To what extent, if at all, have you had representations made by reason of the budget statement made on June 3 of this year and by reason of the publicationof this Bill C-140?

Mr. Loomer: There were some representations primarily with regard to the acceleration of the Kennedy Round reductions. There were relatively few, considering the scope of these reductions. That is the main area in which we had representations. There are always representations from companies whose requests are not met in the budget, of course.

The Chairman: What I meant was were there any representations made by people who said they wished to appear before a committee of Parliament?

Mr. Loomer: No, I am not aware of any.

The Chairman: Are there any other questions on this bill? It is pretty straightforward for a Customs Tariff bill.

Senator Carter: Section 1 could be a standard wording for this principle to be incorporated in any legislation. All you have to do is to refer back to this section 1.

The Chairman: No, we would not do it that way. We would incorporate the same language in whatever bill was before us. It is a thought for the future, senator. Are there any other general questions, or shall I report the bill without amendment?

Senator Kinley: Different parts of the schedules come into force at different times.

The Chairman: Originally that was supposed to be so.

Senator Kinley: That is in section 14. Then again it says section 10 shall come into force on the first day of January, 1970.

The Chairman: No. Section 10 of the bill is the section that deals with the tourist exemption, a resident returning to Canada. That increased exemption comes into force on the first of January, 1970. The other parts of the bill dealing with the Kennedy Round and miscellaneous tariff items, being sections 4 to 9, are deemed to have come into force on June 4, 1969. They have been in force since that time.

Senator Kinley: I thought it was interesting when you spoke yesterday with regard to the percentage aspect. While you have a percentage in the price raises you might be really raising the duty if the percentage with relation to the value of the goods is in the present inflation. I think that is a very important part of this act.

The Chairman: I think I said the reduction in price that might ordinarily be expected to flow from a reduction in tariff—and that was the intention of this, as Mr. Loomer said, to deal with the problem of inflation—inflation having gone ahead, may have taken up the increased costs by reason of inflation.

Senator Kinley: What part of our revenue is now customs tariff? It used to be very important years ago.

The Chairman: We will have that figure for you in one minute.

Senator Kinley: Are we getting to be a low tariff country?

Mr. Loomer: I think the tariff as a source of revenue has dropped.

Senator Kinley: We in the Maritimes think of the rest of the central provinces as our greatest competitor. While we have regard to imports, state imports are very restrictive sometimes.

The Chairman: I think you can conclude that tariff revenues have decreased. Certainly the Kennedy Round has produced about $50 million of reduction this year.

Senator Molson: Has there been any impact on inflation in the six months?

The Chairman: Mr. Loomer was asked that question earlier and said it is difficult to segregate that item and make any demonstration of it except in the area of export, and the export business has increased. In other words, more outside market opportunities have developed.

Senator Molson: That has not had much direct effect on inflation in that sense. I said on inflation.

The Chairman: I do not profess to be able to answer that. I might have ideas about it. What is the figure, Mr. Loomer?

Mr. Loomer: For the fiscal year 1968-69 customs duties amounted to $762 million out of total budgetary revenues of around $10 billion, so it is less than 10 per cent.

Senator Kinley: It is only about one-tenth of our revenue?

Mr. Loomer: Yes.

The Chairman: Are you ready for the question? Shall I report the bill without amendment?

Hon. Senators: Agreed.

The Committee adjourned.

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Ottawa, 1969

Second Session—Twenty-eighth Parliament

1969

THE SENATE OF CANADA

PROCEEDINGS

OF THE

STANDING SENATE COMMITTEE

ON

BANKING, TRADE AND COMMERCE

The Honourable LAZARUS PHILLIPS, *Acting Chairman*

No. 4

THURSDAY, DECEMBER 18th, 1969

Complete Proceedings on Bills C-155, S-15 and S-16,

intituled respectively:

"An Act to amend the Excise Tax Act";
"An Act respecting McOuat Investments Limited"; and
"An Act respecting Buccaneer Industries Ltd.".

WITNESSES:

Department of Finance: F. R. Irwin, Director, Tax Policy Division. *McOuat Investments Limited & Buccaneer Industries Ltd.:* C. C. McOuat, Vice President and Director; D. J. Johnston, Parliamentary Agent.

REPORTS OF THE COMMITTEE

21223—1

THE STANDING SENATE COMMITTEE ON

BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aird	Croll	Lang
Aseltine	Desruisseaux	Leonard
Beaubien	Gélinas	Macnaughton
Benidickson	Giguère	Molson
Blois	Grosart	Phillips (*Rigaud*)
Burchill	Haig	Savoie
Carter	Hayden	Walker
Choquette	Hollett	Welch
Connolly (*Ottawa West*)	Isnor	White
Cook	Kinley	Willis—(30)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extracts from the Minutes of the Proceedings of the Senate, December 17, 1969:

"Pursuant to the Order of the Day, the Honourable Senator Cook moved, seconded by the Honourable Senator Inman, that the Bill C-155, intituled: "An Act to amend the Excise Tax Act", be read the second time.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative, on division.

The Bill was then read the second time, on division.

The Honourable Senator Cook moved, seconded by the Honourable Senator Inman, that the Bill be referred to the Standing Senate Committee on Banking, Trade and Commerce.

The question being put on the motion, it was—
Resolved in the affirmative."

"Pursuant to the Order of the Day, the Honourable Senator Phillips (*Rigaud*) moved, seconded by the Honourable Senator Gouin, that the Bill S-15, intituled: "An Act respecting McOuat Investments Limited", be read the second time.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative.

The Bill was then read the second time.

The Honourable Senator Phillips (*Rigaud*) moved, seconded by the Honourable Senator Gouin, that the Bill be referred to the Standing Senate Committee on Banking, Trade and Commerce.

The question being put on the motion, it was—
Resolved in the affirmative."

"Pursuant to the Order of the Day, the Honourable Senator Phillips (*Rigaud*) moved, seconded by the Honourable Senator Urquhart, that the Bill S-16, intituled: "An Act respecting Buccaneer Industries Ltd.", be read the second time.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative.

The Bill was then read the second time.

21223—1½

The Honourable Senator Phillips (*Rigaud*) moved, seconded by the Honourable Senator Urquhart, that the Bill be referred to the Standing Senate Committee on Banking, Trade and Commerce.

The question being put on the motion, it was—
Resolved in the affirmative."

ROBERT FORTIER,
Clerk of the Senate.

MINUTES OF PROCEEDINGS

THURSDAY, December 18, 1969.

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m.

Present: The Honourable Senators Blois, Carter, Connolly (*Ottawa West*), Flynn (*Ex Officio*), Haig, Kinley, Leonard and Phillips (*Rigaud*). (8)

Upon motion it was Resolved that the Honourable Senator Phillips (*Rigaud*) be elected *Acting Chairman.*

In attendance: E. Russell Hopkins, Law Clerk and Parliamentary Counsel.

It was Agreed that 800 copies in English and 300 copies in French of these proceedings be printed.

The following Bill was examined:

Bill C-155: An Act to amend the Excise Tax Act.

Witness: *Department of Finance:* F. R. Irwin, Director, Tax Policy Division.

Upon motion it was Resolved to report the said Bill without amendment.

At 10:10 a.m. the Committee proceeded to the next order of business.

Bills S-15 and S-16, intituled respectively: "An Act respecting McOuat Investments Limited" and "An Act respecting Buccaneer Industries Ltd." were examined jointly.

The following witnesses were heard: C. C. McOuat, Vice President and Director; D. J. Johnston, Parliamentary Agent.

Upon motion it was Resolved to report the said Bills without amendment.

At 10:20 a.m. the Committee proceeded *in camera.*

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

REPORTS OF THE COMMITTEE

THURSDAY, December 18th, 1969.

The Standing Senate Committee on Banking, Trade and Commerce to which was referred the Bill C-155, intituled: "An Act to amend the Excise Tax Act", has in obedience to the order of reference of December 17th, 1969, examined the said Bill and now reports the same without amendment.

Respectfully submitted.

LAZARUS PHILLIPS,
Acting Chairman.

THURSDAY, December 18th, 1969.

The Standing Senate Committee on Banking, Trade and Commerce to which was referred the Bill S-15, intituled: "An Act respecting McOuat Investments Limited", has in obedience to the order of reference of December 17th, 1969, examined the said Bill and now reports the same without amendment.

Respectfully submitted.

LAZARUS PHILLIPS,
Acting Chairman.

THURSDAY, December 18th, 1969.

The Standing Senate Committee on Banking, Trade and Commerce to which was referred the Bill S-16, intituled: "An Act respecting Buccaneer Industries Ltd.", has in obedience to the order of reference of December 17th, 1969, examined the said Bill and now reports the same without amendment.

Respectfully submitted.

LAZARUS PHILLIPS,
Acting Chairman.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Ottawa, Thursday, December 18, 1969

The Standing Senate Committee on Banking, Trade and Commerce, to which was referred Bill C-155, to amend the Excise Tax Act, met this day at 9 a.m. to give consideration to the bill.

Senator Lazarus Phillips (*Acting Chairman*) in the Chair.

The Acting Chairman: Thank you, honourable senators, for the honour conveyed on me to act as Chairman in the absence of our Chairman Salter Hayden, who asked me to convey to you his regrets at not being able to be with us today.

The first item on the agenda for consideration is Bill C-155, an act to amend the Excise Tax Act. As honourable senators know, this bill was submitted to us for consideration in committee.

We have with us Mr. F. R. Irwin, Director of Tax Policy Division, Department of Finance, who is, of course, known to all honourable senators present. With your concurrence I will ask Mr. Irwin to be good enough to explain the basic highlights of the bill and to answer any questions that you might care to put to him.

Mr. F. R. Irwin, Director, Tax Policy Division, Department of Finance: Mr. Chairman, Bill C-155 is intended to implement a proposal made by the Minister of Finance in his budget speech in June of this year to the effect that a tax would be imposed on the transportation of persons by air. The tax bill has been subject to some work during the summer months and in early autumn. A number of meetings were held with the major air carriers and their associations. They have been very helpful in framing the bill that is now before you.

In working on this bill we had to keep in mind that the northern North America area is really one market area for air transportation business. Air transportation perhaps more than any other business moves freely across borders. The United States has a tax on air transportation at 5 per cent *ad valorem*. That tax applies to flights originating in the United States coming into Canada and returning to the United States.

United States tax does not apply to trans-ocean flights and so, in respect of a tax to be imposed in Canada, these factors had to influence our work and our thinking. The tax that is proposed by this bill is in two parts. There is an *ad valorem* tax of 5 per cent on the amount paid for a ticket for transportation and a flat tax of $5 which may be reduced to as little as $2 on trans-ocean flights. Trans-ocean flights are flights from the taxation area to points outside the taxation area.

This will mean that Canada will be taxing trans-ocean flights whereas the United States at the present time is not doing so.

However, the United States has before Congress a bill which proposes that a tax be imposed on trans-ocean flights and also, incidentally, that their *ad valorem* tax be increased.

Senator Connolly (Ottawa West): Mr. Irwin, are you talking only about travellers or about freight as well?

Mr. Irwin: This bill refers only to the transportation of individuals. It does not propose to impose a tax on transportation of freight.

Senator Carter: How does this bill correspond with the United States bill before Congress? Are they taxing passengers only or passengers and freight?

Mr. Irwin: The United States now tax freight as well as individuals. The bill now before Congress is more comprehensive than this bill in that it also proposes to increase certain user charges. For example, there will be a tax on gasoline and that kind of thing.

They have had one or two bills, and the most recent one would propose increasing the 5 per cent tax to 8 per cent and imposing a $3 tax on international transportation. By international I mean outside northern North America.

Senator Haig: Do you have any knowledge of what revenue this tax will bring in?

Mr. Irwin: We estimate, sir, that it will produce about $20 million on a full year's basis.

Senator Carter: If I recall, there was a vagueness as to how this tax was going to be distributed—whether it was going to accrue to the airport where it was taxed or go into a general fund to be used at the department's discretion. Can you give us any enlightenment on that, or has that point been settled yet?

Mr. Irwin: This bill before the committee is a taxation meaure and it says nothing about how the money is to be applied or spent. Tax revenues, as you know, go into the Consolidated Revenue Fund. There have been suggestions from the industry that this should be earmarked in some way for the improvement of air transportation facilities. I think all I can say is that there are suggestions and representations that the money somehow be taken into account in the efforts of the Department of Transport to charge or receive by way of revenues something equivalent to the cost of the services it provides. But that is a decision that will have to be made in the spending side of the Government's operation and I cannot speak in any detail about it.

Senator Connolly (Ottawa West): Are there methods of avoidance? For example, normally, a return ticket is just twice as much as a one-way ticket. Could you avoid it, say, on an overseas flight by buying a one-way ticket to England, for example? I do not know what the situation there is about tax; if you bought a return ticket when you got there, how would that affect the situation?

Mr. Irwin: I do not think this is a problem under the tax that is proposed here, senator. It would be, if we proposed to impose an *ad valorem* tax on such tickets, but the tax proposed here would be a flat $5.

Senator Connolly (Ottawa West): The *ad valorem* tax would not be applied to overseas flights?

Mr. Irwin: That is correct.

Senator Connolly (Ottawa West): I see. On the overseas flight all you would do would be to pay either the maximum of $5 or the minimum of $2.

Mr. Irwin: That is right.

Senator Flynn: On a return ticket?

Mr. Irwin: On a ticket, whether it is return or one-way.

Senator Flynn: You pay only the $5?

Senator Haig: A maximum of $5.

Mr. Irwin: That is correct.

Senator Carter: What about domestic chartered flights? How do you apply the tax there?

Mr. Irwin: By domestic charter flights, you mean a flight within the taxation area? The *ad valorem* tax of 5 per cent, according to the provisions of the bill, will be imposed upon the amount agreed upon between the organization or group chartering the aircraft and the carrier. There must be a contract or an arrangement that the aircraft plus crew will be provided for so many dollars, and the *ad valorem* tax would apply to that charge. In the case of charter flights going from within the taxation area to a point outside the taxation area, the flat tax would apply to the number of seats that are contracted for. Under this arrangement it will not be necessary to be at the airport at time of departure to see how many people go aboard.

Senator Kinley: Mr. Chairman, the taxation area includes the United States and Canada?

Mr. Irwin: Yes.

Senator Kinley: Then you except Hawaii and St. Pierre and Miquelon. Why is that?

Mr. Irwin: The taxation area is really northern North America starting at the U.S.-Mexican border and going north. It includes St. Pierre and Miquelon, and Alaska because of course Alaska is part of the United States. We excluded Hawaii because it is overseas and we followed the pattern of the United States law in this respect. There they also regard Hawaii as being an overseas flight. The Caribbean countries would also be outside the taxation area.

Senator Blois: For instance, Mr. Irwin, in going to New York, you get a one-way ticket going and a one-way ticket coming back.

What happens in coming back? Does the United States get the benefit of the tax on the return portion?

Mr. Irwin: If purchased in the United States, they would get the benefit of the tax on that portion of the ticket. If it were bought in Canada, Canada would get the whole thing. We look at the sale of the ticket and the tax is applied at the time of the sale of the ticket. I might add that another important consideration in thinking about this tax was the congestion we now have at our airports which is likely to increase, and we were anxious that the flow of passengers through terminals should not be impeded. That is one of the reasons why the tax will be collected at the time of sale of the ticket which in a large number of cases takes place outside the terminal area. If we had turned to a departure-type tax, it might have been necessary, and certainly in some cases it would have been necessary, to have it collected at the time of boarding the aircraft or leaving the terminal.

Senator Connolly (Ottawa West): There would be hopeless confusion at the airports if you tried to collect it there.

Mr. Irwin: We were afraid of that.

Senator Haig: Well, airlines would just have to increase the price of tickets.

Mr. Irwin: To collect this tax, yes.

Senator Blois: What about a flight from Ottawa to Montreal, the fare for which is about $11, will that be $2 or $5?

Mr. Irwin: The flat amount only applies on flights from within the taxation area to points outside the taxation area, in other words, to overseas flights. For all flights within the taxation area it will be the *ad valorem* tax so on the flight from Ottawa to Montreal, the tax would be 55 cents.

Senator McDonald (Moosomin): Why did you not increase the service charges to airlines at the airports rather than putting on this tax? Would it not be a much simpler way of doing it? If you increase your charges for airlines using the airports, then the airlines would pass on this additional cost to the passenger. This is really what you are doing in any event, so would not that have been a much simpler procedure?

Mr. Irwin: I think this is a fair observation. I can only make two comments; first of all we already have quite substantial charges of a user-charge type imposed on all air carriers. These include landing fees. These are quite high and if they were increased I think they would have to be—or perhaps I should not say have to be—logically they would be imposed on all carriers flying in to Canadian airports. I think the Department of Transport is reviewing these charges. The budget speech said user charges were under review, but the air carriers quite naturally are reluctant to see these user-charges increase substantially. They argued that if Canada increases its charges more than some other countries, it would put flights into Canada at a disadvantage compared with flights into other countries. These international comparisons are made. So, you already have these user-charges and they are being reviewed. The other point is that the air carriers themselves suggested that if a further tax is to be imposed on the users of air transportation facilities, it might be better if this were imposed more directly upon the users so that there could be a realization that these services cost money and that the people who use them are paying for them. If a charge were placed upon landing fees or airport use, it might not fall directly upon passengers because the airlines also carry mail and freight. There are many different problems but I am only mentioning some of the considerations involved.

Senator McDonald (Moosomin): But you made a statement a moment ago that the people who use the airports should pay part of the cost. But I cannot see the equity in the system you are proposing in putting on an *ad valorem* tax. If I fly from here to Toronto, I use two airports and then on my return I use two airports again. Now the fare is, I think, $40 so $2 would represent my charge for using two airports on two different occasions. But if I fly from my own home to Ottawa, I still use two different airports, but it costs me $9. So I do not think this amounts to a airport-use tax at all. You are penalizing people who because they live in centres in Canada long distances from major cities—you are penalizing these people as much for one trip as you are penalizing other persons for five trips, and I think your tax is very unfair.

If you are going to have a flat rate of either $2 or $5 for international routes out of Canada, then why on earth do you not have the same fixed rates for internal flights? Why have a $2 airport tax whether you fly from

here to Montreal or from here to Vancouver? You are penalizing those who live long distances from major cities, and in many instances you are penalizing those with the least ability to pay. Surely, the principle of taxation should be to tax on the basis of ability to pay, and this tax follows the exactly opposite principle. In northern Canada incomes are much lower than they are, say, for argument's sake, in Ottawa, yet these people pay a far greater tax.

Senator Flynn: For the same service.

Senator McDonald (Moosomin): Yes, for the same service.

Senator Connolly (Ottawa West): I wonder whether that argument does not apply to almost any excise tax, because goods which may be sold in one part of the country for a certain price may be sold at a higher price in another part of the country.

Senator McDonald (Moosomin): This is true, but you cannot correct one wrong by another wrong, and this is discrimination against those areas of Canada already taxed in excess compared to other parts of Canada.

Mr. Irwin: Mr. Chairman, it would be quite inappropriate for me to enter into the debate on this matter.

The Acting Chairman: On the philosophy of taxation on the basis of ability to pay.

Mr. Irwin: I will mention the points which might have a bearing on it. The first is that this is a consumption tax; it is not a user tax. It is quite true that the tax was announced in the context of a paragraph or two which spoke about user charges and the high cost of airports, but it did also speak about a tax on tickets. When this was debated in the other place the minister who was speaking to the bill, the Honourable Mr. Gray, emphasized that there were charges other than airport charges, and that this was regarded as a necessary measure to get more money because of air transport facilities being so expensive and becoming increasingly so.

Perhaps I should not try to repeat the debate, but in the other place there was quite a bit said about the use of the flat kind of tax as compared to an *ad valorem* consumption tax. A flat tax would be a different kind of tax, and this issue was debated.

Senator Flynn: This is what we are debating.

Senator McDonald (Moosomin): Really, you are not putting a user tax on the airports, but internally, in Canada, you are putting a tax on air travel, because you use the airport whether you fly from here to Montreal or from here to Goose Bay.

Mr. Irwin: That is quite right.

Senator McDonald (Moosomin): But your tax is not on airports; it is on air travel: the farther you travel, the more you pay.

Mr. Irwin: I think that is quite right.

Senator McDonald (Moosomin): But that is not what you set out to do. You set out to put a charge on the use of airports, to help build Canadian airports across Canada. This is not what you are doing now. You are taxing air travel, which has nothing to do with the use of airports.

Senator Connolly (Ottawa West): I think the rationale behind it does not matter once you get the bill, but I think your argument on the first part is a very good one. Mind you, it touches questions of policy which Mr. Irwin probably cannot deal with.

Senator McDonald (Moosomin): I appreciate that, Senator Connolly, but the major expenditures on new airports will be in the larger cities of Canada, where the users of those airports are going to pay a very small piece, and the people who are really going to pay for the construction and maintenance of airports in Montreal, Toronto, Vancouver and, perhaps, one or two other cities, are going to be people from other parts of Canada. It is extremely unfair.

Senator Connolly (Ottawa West): What would be the maximum *ad valorem* tax that would be paid? In other words, what is the cost of the longest return flight you can take in Canada? Presumably, it would be from St. John's, Newfoundland to Victoria, B.C.

Senator Flynn: Or Los Angeles.

Senator Leonard: Senator Connolly, travelling first class, accompanied!

The Acting Chairman: To make it pointed, let us say, first class.

Senator Connolly (Ottawa West): There are very few who travel first class, and there will be fewer now.

Mr. Irwin: I have the economy fare, one way, from Vancouver and Victoria to St.

John's, Newfoundland, which we thought would probably be the longest flight in Canada. The one-way economy fare is $209, so the tax would be $10.45.

Senator Connolly (Ottawa West): One way?

Mr. Irwin: Yes.

Senator Flynn: And on the return the tax would be $21. Why a flat rate on international flights? Why the difference?

Mr. Irwin: In the case of international flights, as I mentioned earlier, we were severely restricted by the fact that the United States does not tax such transportation, and if there were any substantial differential in the cost of flights from Canadian exit points and U.S. exit points, there would be serious diversion of traffic and the Canadian carriers would lose business.

Senator Leonard: What is the situation with respect to paying this tax if you are using a charge card, a travel card?

Mr. Irwin: The sale would be deemed to have taken place when the ticket is provided; there is a sale to you of air transportation at that time. There is then an arrangement, really between you and the airline or someone acting for the airline, that this payment will be made some time later.

Senator Leonard: In other words, it does not have to be paid in cash at the time of presentation for boarding?

Mr. Irwin: No, the air carrier is the collector and would be responsible for paying the tax at the time stipulated in the bill. The arrangement it makes with the passenger for payment is its business.

Senator Leonard: That complies with section 12, where it says:

> ...and in any case prior to the provision of the transportation

—the tax on each amount paid or payable for transportation is payable. That is at the bottom of page 3 of the bill.

> (a) at the time when the amount is so paid or becomes payable and in any case prior to the provision of the transportation;

Mr. Irwin: This is the section that imposes the tax, and that is when the tax becomes payable. The carrier is not required to remit the tax to the Department of National Revenue until the end of the month following the month in which the sale is made. The time for payment is the same as that for other excise taxes.

Senator Leonard: It also says that it is payable "by the person making the payment." If you read that literally, we are depending on Air Canada saying, "We agree to this tax being added to our accounts." Then you say under the act you must pay this at the wicket.

Mr. Irwin: I think this is probably true. We had some discussions with the carriers on this, who made somewhat the same point.

Senator Leonard: Can we somewhere find an assurance that carriers will treat this payment as eligible to be charged and not paid in cash?

Mr. Irwin: That was certainly the understanding we had in our discussions with them.

Senator Connolly (Ottawa West): Under section 17, where you have authority to make regulations, have you authority to make a regulation requiring the carrier to collect the tax when he collects for the ticket? I suppose generally for carrying out the provisions of this part of the bill paragraph (g) would give you a pretty large basket.

Mr. Irwin: Yes, I think this is right.

Senator Leonard: If everybody had to pay a tax when they stepped up to the wicket, it would delay matters.

Senator Connolly (Ottawa West): It would be hopeless.

Mr. Irwin: The tax would be payable at the time money changes hands.

Senator Connolly (Ottawa West): Look at paragraph (f).

Senator Flynn: What if the carrier is unable to collect the tax later on?

Senator Connolly (Ottawa West): Perhaps the answer to all these questions is in section 18 (f):

> prescribe, in cases where an air carrier provides transportation of a person by air on credit, the time when and the place where the amount payable for that transportation is deemed to be paid or payable for the purposes of this Part.

Senator Leonard: That has to be done by regulation.

Mr. Irwin: Yes, sir.

Senator Leonard: I take it it is proposed to deal with this by regulation so that the tax can be charged instead of paid by the passenger?

Mr. Irwin: Yes, sir. We are aware of the problem you mentioned. It is my understanding that a person will not have to pay tax before he has paid for his ticket. I think that is really the point.

Senator Flynn: When the tax is not collected what will happen? Will the carrier have to pay it just the same?

Mr. Irwin: The carrier has the responsibility of collecting and remitting the tax, yes.

Senator Flynn: And if he does not succeed in collecting the tax, it will have to be paid just the same?

Mr. Irwin: I think that is correct, sir.

The Acting Chairman: I would think so, if he agrees to extend credit pursuant to the regulations.

Senator Connolly (Ottawa West): This is perhaps outside the bill. With the general tendency to discourage travel by rail, by perhaps eliminating it, and there being very little of water transportation, I take it this is the only form of transportation that will be taxed. There is no tax on a railway ticket, I suppose?

Mr. Irwin: That is correct.

Senator Connolly (Ottawa West): There is no water transport of any consequence, and in any event it is not taxed.

Senator Flynn: This is the problem, because it should not be a tax. I do not think it is very skillful politically to impose a tax instead of building into the price of the ticket the charge for air transportation facilities. In section 18, paragraph (c) says:

> The Governor in Council may by regulation...
>
> Exempt from the operation of this Part the transportation of a person by air.

That goes a little far, does it not? The Government could decide that I, for instance, would be exempt from paying the tax.

Mr. Irwin: The regulation-making power here is quite broad, for two reasons I suggest. First, this is a new tax; we are breaking new ground, and perhaps in an abundance of caution the bill proposes quite sweeping regulating powers. The other and more technical point is that the bill imposes a tax on all transportation by air.

Senator Flynn: Of persons.

Mr. Irwin: Transportation of persons by air. Then it requires that licensed carriers shall collect and remit the tax. It will be necessary to provide that certain classes of transportation do not have to bear the tax. For example, there may be some charter flying in Canada by large freighter aircraft with one or two seats in the rear, but which is almost entirely a freighting operation. This regulatory power enables the Government to say that charter flights using a certain kind of aircraft on a flight between certain northern points, where there is normally no passenger carrying capacity, shall not be covered. That is the kind of thing this will permit the Government to do.

Senator Flynn: It will allow more than that, but that is what the department had in mind?

Mr. Irwin: Yes, sir.

Senator Connolly (Ottawa West): Even where a fare is paid for that seat?

Mr. Irwin: Usually no fare would be paid for that seat. That is the problem. It would be a charter flight; the person chartering the aircraft pays so much a flight or per month and can use it as he wishes; I am thinking of the kind of aircraft that carries freight.

Senator McDonald (Moosomin): What is the situation with regard to Canadian Armed Forces aircraft?

Mr. Irwin: They would not be a certified air carrier by definition.

Senator Flynn: And they do not charge.

Mr. Irwin: That is so.

Senator Flynn: Under paragraph (d) of section 18, again the powers given would not be too wide. It says:

> determine for the purposes of this Part when transportation begins or ends
>
> (i) at a point in Canada,
>
> (ii) at a point in the taxation area,
>
> (iii) outside Canada, or

(iv) outside the taxation area.

In other words, you could change the taxation area.

Mr. Irwin: No, sir. I do not think the regulations could change the taxation area, but it will be necessary to add more substance to the words "beginning at a point in the taxation area and ending at a point in the taxation area".

We found that the air transportation business is very complicated and very technical and we did not want to try to define every case when a flight shall be deemed to begin and to end. For example, a person may buy a ticket in Toronto intending to go to London, England. He may stop over in New York, however, for two weeks. Is that a flight which begins in Canada and ends in London, England, or is it a flight which begins in Canada and ends in New York and another flight that begins in New York and goes on to London, England?

Senator Flynn: I pity you for having to solve all these difficult problems.

The Acting Chairman: Honourable senators, are there any further questions?

Senator McDonald (Moosomin): I have just one further comment I want to make, Mr. Chairman. You can gather from my remarks so far that I think the tax is discriminatory, in that the greater part of the revenues are going to come from people who live in outlying areas.

I can refer to my own province of Saskatchewan and to my own city, Regina, where our air facilities are anything but adequate. The service provided there by Canada's national airline is almost ridiculous. Nevertheless, we are the ones who are going to pay far more tax and it is for that poor service and for the poor facilities, and our money is going to be used to provide facilities in the major cities of Canada. I have no objection to the facilities in the major cities in Canada being improved, but I think that the people who use those facilities ought to be the people who are paying for them, and this tax is not designed to have the people who are using the facilities pay for them.

I repeat that it is a tax on air travel. The further you travel the more you pay. Those people who live the furthest distance from our nation's capital and from its major cities are going to carry by far the largest burden. The tax is unfair and is based on the wrong principle of taxation, and I know that the people I represent are violently opposed to this tax, and I feel that you should reconsider the whole principle of this tax and get back to the basis of ability to pay and back to the basis of an airport user's tax.

There are many countries in the world today which have an airport user's tax, by which means you pay $2 or $2.50, or whatever it is, when you leave the airport, and it seems to me that, if in Canada you were to follow that principle, which is well recognized in many parts of the world, then you would have a far fairer tax so far as Canadians generally are concerned.

I object most strenuously to another discrimination against people in Canada who have been discriminated against throughout history in our taxation system; and this is just another example of that.

Senator Flynn: I am pleased to see that Senator McDonald shares the views I expressed yesterday in the house.

Senator Leonard: Mr. Chairman, I can understand Senator McDonald's first point about the discrimination in respect of the distances involved when one resides far from the major airports. But I would not like him to get away with the suggestion that we should pay some flat tax like some of these other countries do, because that is a pure nuisance tax and is really imposed more upon foreigners than upon residents of the particular countries involved, and such a tax causes more ill will than it is worth to the country imposing it.

If we were to impose a tax, just a flat tax, as people take the airplane, that would react largely against the people travelling in Canada from outside Canada.

The Acting Chairman: Honourable senators, is it your conclusion that we report this back without amendment?

Senator Flynn: On division.

The Acting Chairman: Agreed. Thank you very much, Mr. Irwin.

Honourable senators, we now have before two private bills, Bill S-15, an act respecting McOuat Investments Limited, and Bill S-16, an act respecting Buccaneer Industries Limited. Would it be in order, honourable senators, to have the evidence given in respect of Bill S-15 apply as well to bill S-16 for the reasons explained yesterday?

Hon. Senators: Agreed.

The Acting Chairman: Thank you. We have available Mr. C. C. McOuat, Vice-President and Director of McOuat Investments Limited, and Mr. D. J. Johnston, I am glad to say one of my honoured colleagues from the firm of McCarthy, Monet, Johnston and Heenar of Montreal, and Mr. J. Gick of Clarkson Gordon, if it is felt that we require information from him as well.

Senator Flynn: Is there anybody from the corporations department?

The Acting Chairman: No, but as I indicated to you, Senator Flynn, with respect to the corporations department, Mr. Basford wrote a letter to Mr. Johnston, which Mr. Johnston can explain, in which Mr. Basford indicated to Mr. Johnston that in principle he had no objection to the reconstitution of the companies, but pointed out that in the final analysis it would be a matter to be considered by the Senate and the House of Commons.

Senator Flynn: May I suggest that that is the only point we need to consider. Perhaps if you filed that letter, that would be sufficient for our purposes.

The Acting Chairman: There was a suggestion from Senator Croll that he would like to have on record, Senator Flynn, the reasons why there was this oversight in the filing. Do you mind if we get that question put in? Mr. McOuat, would you please come forward?

Mr. McOuat, there was some feeling in the debate yesterday that you should explain to the honourable members of this committee why there would have been an oversight in the filing of these returns which brought about the loss of your charters for these two companies. I understand you operate in Lachute in the rural area. Was it a fault of your employees which was not brought to your attention?

Mr. C. C. McOuat, Vice-President and Director, McOuat Investments Limited: Mr. Chairman, honourable senators, I would answer yes to that question. This was certainly an omission or an oversight on the part of our staff at our head office in Lachute, Quebec.

The Acting Chairman: Just one further direct question to you. Did you at any time consult your counsel or your accountants with a desire to surrender these charters?

Mr. McOuat: No, never, sir.

The Acting Chairman: I ask that because I wanted to know whether this was an indirect way of bringing about surrender and then a subsequent change of plans. I wanted that on record.

Senator Connolly (Ottawa West): How are these companies incorporated, Mr. Chairman? Are they incorporated by Letters Patent?

Mr. McOuat: Yes.

Senator Connolly (Ottawa West): Federally?

The Acting Chairman: Yes, and the charters were lost under section 125(12) because of the failure to file these returns.

Senator Connolly (Ottawa West): It seems to me to be a very onerous way for a company to re-establish itself, having to go through Parliament and incorporate under Letters Patent.

Senator Flynn: That was the question I put yesterday. My idea was to discuss that point with an official of the department had there been one here.

The Acting Chairman: We could, Senator Flynn, use the experience in these companies as justification in due course of dealing with it.

Are there any further questions, honourable senators? Mr. Johnston, would you mind coming up here? Mr. D. J. Johnston is one of my respected colleagues at the Quebec Bar.

Mr. Johnston, perhaps you would be good enough to answer the point raised with respect to the attitude of Mr. Basford and his department on this matter?

Mr. D. J. Johnston (Counsel for McOuat Investments Limited): Honourable senators, we wrote to Mr. Basford's department and asked whether that department would have any objections to the presentation of these bills. I might add that his department had already written to the Senate advising that in their view this was the only manner in which these companies could be reconstituted. I have here a letter from Mr. Basford, dated November 28, 1969, from which I would like to quote the following:

> Your letter indicates that it is the intention to present private bills confirming the existence of these two corporations retroactively to the dates of their

respective dissolution. You would like to obtain our assurance that we will not object to the bills in question.

I do not need to tell you, of course, that the granting of the relief sought by your clients will be one for Parliament to decide. I should add that, insofar as we are concerned, we have no objection, as a matter of principle, to the procedure of private bills of Parliament being followed to revive corporations that have been dissolved pursuant to Section 125 of the Canada Corporations Act, as this might be the only way to correct some public injustice or hardship.

We are not in a position, however, to give you, at this time, a firm assurance that we will not object to the bills in question. When these bills are presented, they will undoubtedly be referred to a committee of the House of Commons and of the Senate where the persons seeking the relief will be called upon to testify. You will agree with us that the testimony that will be given at that time may have some bearing on our final position regarding the granting of these bills. Subject to that caveat, it would not be our intention, on the basis of the information that has already been placed before us, to oppose the bills in question.

I might add that the information which was placed before Mr. Basford's department was essentially the same as that which you have heard today, namely that there was some omission on the part of the clerical staff of these companies in forwarding these returns.

Senator Connolly (Ottawa West): Will you now be required to supply the information for the years during which you omitted to supply it?

The Acting Chairman: That is provided for in the bill, senator. It says that the condition of the revival is based upon the filing within 60 days from Royal Assent of all the returns required and the rights and obligations of the parties remain as if there had been no dissolution. If, however, they fail to file their returns satisfactorily to the department, then the revival is inoperative.

Senator Connolly (Ottawa West): A point which comes to my mind is this; since we have officials of the department here, should we not direct an inquiry to them as to whether this act could not be amended, the Canada Corporations Act, to enable this remedy to be provided without the necessity of applying for a private bill in Parliament?

The Acting Chairman: Perhaps that could come by way of a suggestion from this committee. Would that be satisfactory honourable senators? I am in your hands on this.

Senator Connolly (Ottawa West): Well, I do not think we should burden these people with that aspect of it but we might ask the secretary to send a copy of today's proceedings to the Minister concerned.

Senator Flynn: And also to the Minister in charge of Corporate Affairs. And Mr. Delasage.

The Acting Chairman: Are there any other questions, honourable senators?

In the absence of any further questions, shall we report the bills without any amendment?

Hon. Senators: Agreed.

The Acting Chairman: Thank you very much.

The committee adjourned.

Queen's Printer for Canada, Ottawa, 1969

Second Session—Twenty-eighth Parliament
1969-70

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE
ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 5

WEDNESDAY, JANUARY 28th, 1970

First Proceedings on the Government White Paper,
intituled:
"PROPOSALS FOR TAX REFORM".

WITNESSES:

Department of Finance: R. B. Bryce, Deputy Minister and
J. R. Brown, Senior Tax Adviser.

APPENDIX:

"A"—Effect on tax revenues caused by White Paper proposals for
Tax Reform.

21284—1

THE STANDING SENATE COMMITTEE ON

BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aseltine
Beaubien
Benidickson
Blois
Burchill
Carter
Choquette
Connolly (*Ottawa West*)
Cook
Croll
Desruisseaux
Everett
Gélinas
Giguère
Grosart
Haig
Hayden
Hays
Hollett
Isnor
Kinley
Lang
Leonard
Macnaughton
Molson
Phillips (*Rigaud*)
Walker
Welch
White
Willis—(30)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

"With leave of the Senate,
The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intituled: "Proposals for Tax Reform", prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

"With leave of the Senate,
The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, January 28, 1970:

"With leave of the Senate,
The Honourable Senator McDonald moved, seconded by the Honourable Senator Langlois:

That the names of the Honourable Senators Everett and Hays be substituted for those of the Honourable Senators Aird and Savoie on the list of Senators serving on the Standing Senate Committee on Banking, Trade and Commerce.

The question being put on the motion, it was—
Resolved in the affirmative."

ROBERT FORTIER,
Clerk of the Senate.

21284—1½

MINUTES OF PROCEEDINGS

WEDNESDAY, January 28th, 1970.

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:20 a.m. to further consider:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Hayden (*Chairman*), Beaubien, Benidickson, Blois, Burchill, Carter, Cook, Croll, Desruisseaux, Flynn, Gelinas, Giguere, Haig, Isnor, Kinley, Leonard, Macnaughton, Molson and Phillips (*Rigaud*)—(19).

Present, but not of the Committee: The Honourable Senators Everett, Hays, Laird, McDonald, McElman and Sullivan—(6).

In attendance: Arthur W. Gilmour, Senior Advisor; Alan J. Irving, Legal Advisor and R. Bretton, Executive-Secretary.

Upon motion it was Resolved that 5000 English and 2000 French copies be printed of the Committee proceedings respecting the White Paper on Tax Reform.

The following witnesses were heard:

Department of Finance:

R. B. Bryce, Deputy Minister.
J. R. Brown, Senior Tax Adviser.

At 12:00 Noon the Committee adjourned until Thursday, January 29th, at 9:00 a.m.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Ottawa, Wednesday, January 28, 1970.

The Standing Senate Committee on Banking, Trade and Commerce, met this day at 9 a.m. to give consideration to the White Paper entitled, "Proposals for Tax Reform".

Senator Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: Honourable senators, I take it I do not need to tell you that you have appearing before you today Mr. Bryce and Mr. Brown. We had Mr. Brown appear before us when we were dealing with the estate tax and the life insurance companies' taxation legislation. I told him that I remember him when we tried to storm the ramparts a number of times and he was there, in his own way, defending or attempting to defend them.

I should like to make an announcement before we proceed any further. In so far as this committee is concerned, up to this moment we have had about 250 statements from organizations, companies and associations that they intend to file a brief and make a submission and I would say that about 95 per cent of them have indicated that they wish to appear and supplement their submission. Our advice, which we have given before, is that we do not operate on any restrictive basis. All we have asked them is: "Will you please get your brief in with all convenient speed, and will you please indicate to us three acceptable dates on which you could appear, so we can do a little co-ordinating. Then, if you wish to appear as well before the Commons committee on the same date, we will try to co-ordinate that."

Our well-known position was stated in the release we made recently. That is that when people request to be heard before a Senate committee they are heard, unless we consider it is just some wild-eyed nonsensical approach. Otherwise we have no time limitation. For instance, we know that the earliest moment at which the Canadian Bar Association can appear before us is the first week in May, and we have told them that as far as we are concerned that is satisfactory.

We want to give this matter as intensive a study as we can, but we think with regard to everyone who has a presentation to make that we must assume, until we actually see the presentation, that it is a matter of substance.

Of course, it may be that in analyzing the briefs later we will come to the conclusion that there are a series of briefs that really deal with the same point, proceed along the same lines and raise the same issues. We may try to co-ordinate them and suggest a convenient period of time during which they could appear before us together so that we would have one discussion on those points.

Outside of that, we are here to hear the case, and we are sitting here in an objective capacity. No one has committed himself in any debate in the Senate, because this motion was not debated, and we are going to be as objective as we can and see what information we can get and what conclusions we can reach.

I think we should increase the number of copies of our proceedings we normally have printed. There will be quite a demand, and I would suggest that we have 5,000 copies in English and 2,000 in French.

> Upon motion, it was *resolved* that a verbatim report be made of the proceedings and that 5,000 copies in English and 2,000 copies in French be printed.

Then, let us proceed with our search for information. Senator Phillips, I believe you have a series of questions that you would like to ask.

Senator Phillips (Rigaud): Thank you, Mr. Chairman. I suppose, Mr. Bryce, if we were to compare the White Paper to a sandwich we would more or less all agree that chapters 1 and 8 comprise the bread, and are more or less happily and mellifluously phrased, but a general impression is rampant that chapters 2 to 7 inclusive contain the biting mustard of the sandwich.

Briefs will be presented to us in this committee, and we, acting in a judicial capacity,

feel that we need the benefit of your and your department's clarification and, to some extent, advice with respect to the interpretation of certain phases of this White Paper. It is against that background that I understand the chairman, supported by his colleagues in this committee, has asked you to be good enough to come here to guide and inform us.

That being so, Mr. Bryce, may I start the discussion by submitting to you a few general questions, realizing that in the process you may at this stage not be in a position to file the material that I would like you to file. If that is the case, and if the chairman finds it in order that material may be filed at a later time.

There is certainly an important segment of public opinion in this country that has expressed the view that if the proposed system of taxation contemplated by this White Paper were enacted into law the effects in so far as the overall economy is concerned would be inflationary, and, therefore, inconsistent with the current demand of the administration that at all costs inflation should be curbed. I would like to know whether your department has studied, preparatory to the submission of this White Paper, what the consequences of the introduction of legislation based on this White Paper would be in terms of inflationary or deflationary results for the next five years.

Mr. R. B. Bryce, Deputy Minister of Finance: Thank you, senator. I would make several points in response to that. First, these proposals are essentially long term proposals. They are not proposals for immediate tax policy to deal this year with the current economic situation, and inevitably one has to bear in mind that what is an opportune time from a long term point of view may not be an opportune time from a short term point of view. We would, therefore, have to recognize that there is some possibility here of a conflict between the immediate short term influence and the longer term influence.

The chief ground for the argument that proposals of this kind may contribute to inflationary tendencies is that they have a significant influence on savings in the economy, and to this some have added that they tend to increase spending.

Now, it is true that they do have a significant influence on savings. We say this in chapter 8, and we endeavour to estimate not only what that is quantitatively in terms of the scale of the economic magnitudes in 1969, but also in terms of the first and the fifth year of the impact of the proposals.

To deal with the effect on spending first, I will say that the increase in the exemptions and the changes in the rate schedules, and other things directly affecting personal incomes, would, we estimate, decrease personal savings and, therefore, presumably increase personal spending, by a relatively modest amount. In paragraph 8.41 on page 92 we say that our estimate of the reduction in personal savings, apart from the items implementing the integration of the corporate and personal tax, would reduce personal savings modestly, and we estimate the amount might be about $30 million in the first year and $75 million in the fifth year. That, I think, indicates that its effect in increasing spending on balance by individuals is relatively modest, bearing in mind the fact that there are many offsetting items which are illustrated in Table 15 as a result of one thing and another.

However, we think the effect of the change in the credits for corporate tax to individuals will mean that there is an increased personal saving to offset some of the corporate saving. This, therefore, carries us over to the corporate sector. It is in the corporate sector that we get the main impact on savings. Therefore, if there is any increase in expenditure it is not apt to be in corporate expenditure. It is a question of what the Government is going to do with the increased revenues.

That brings us to the question of what fiscal policy or what expenditure policy governments will make, and the degree to which there will be inflationary consequences as a result of the increased corporate tax revenues which the federal and provincial governments get will depend upon what kind of fiscal policy is followed.

The Chairman: May I interrupt you there, Mr. Bryce? This means, then, that this is directed from just one side? In other words, what is the fiscal policy going to be in future years in relation to the expenditure of additional revenues is something that is uncertain or unknown, or is something that has not been calculated or estimated? Is that it?

Mr. Bryce: It is not yet determined.

The Chairman: So we are making sure that we are going to get the money first?

Mr. Bryce: Well, sir, the additional revenue in the first year particularly is, as the Minister of Finance has said, very modest in amount, and we have erred a little on the

side of more revenues rather than less, as can be seen from the estimates here.

Senator Phillips (Rigaud): Modesty, Mr. Bryce, is a matter of opinion. Some people think mini skirts are modest, but others think otherwise.

Mr. Bryce: As you will see from paragraph 8.1 on page 85 of the White Paper, the estimated change overall is a small reduction in overall personal tax revenue, an increase in corporate tax revenue, and a small decrease in the withholding tax revenue, giving an overall increase in revenue of $165 million.

That is $165 million on a total of $11 billion, so that it is 1½ per cent, or something of that order of magnitude. If that comes into effect next year the real question is going to be what the Government's expenditure policy will be in the light of that. The impact on personal spending is small enough that it may be offset by other things and, indeed, it is a small fraction of one per cent of the G.N.P.

Senator Phillips (Rigaud): Is there a working paper in the department dealing specifically with the inflationary or deflationary effects of the formulas proposed in the White Paper and, if so, is it available to this committee?

Mr. Bryce: We do not have a paper on that point, but if you wish to have one we can produce it.

Senator Phillips (Rigaud): I just want to know whether there is existing at this stage such a study?

Mr. Bryce: No.

The Chairman: Do you mean whether such a study has been made?

Senator Phillips (Rigaud): Yes, I am assuming that if a study had been made it would be reflected in a working document.

Mr. Bryce: Many of these points are reflected in conversations and discussions.

The Chairman: Is this not so important with regard to the possible effect of this White Paper on inflation that there should be some memorandum?

Senator Beaubien: How does Mr. Bryce arrive at the figure of $30 million as the estimated amount in the first year if there is no working paper?

Mr. Bryce: The working paper Senator Phillips was asking about was with regard to the inflationary effects. We have had many working documents on the savings impact.

Senator Leonard: Could we not follow up the suggestion by having a paper specifically in connection with the question Senator Phillips has been asking regarding the inflationary aspects?

Senator Phillips (Rigaud): If there is not such a paper I will not press the point. I would suggest, however, that maybe you could come across some departmental information which you might be able to convey through our chairman. The White Paper obviously deals with the subject matter of 1967 taxation data and it is computerized in modernized fashion to produce 1969 results.

Since we have been projecting ourselves five years forward, did the department study the subject matter of a possible increase in G.N.P. for the five year period from 1970 to 1975? If that material were available we would, of course, have some information regarding the increased receipts of tax based upon the White Paper formula. Have you such a document?

Mr. Bryce: Senator, the figures provided and the estimates made are based on the 1967 data to which you referred, which we have tried to project forward to 1969. We have not for the tax reform proposals tried to project this forward to show what they would yield in 1975 by assuming or forecasting the changes in Gross National Product. We do for other purposes project our revenues forward and forecast on a short term basis what our revenues will be in the next ensuing year. In doing this we normally make a forecast of what the Gross National Product and its various components will be, for example, now in 1970. We have made such a forecast. We do not publish the forecasts until they appear in the budget, at least the basic data.

In projecting further forward, what we do, sir, is use assumptions rather than anything we claim to be an accurate forecast and, broadly speaking, in doing this work currently we are assuming that the Gross National Product will grow at a rate of about 7 per cent. In refining that we also assume that we will have some success in the anti-inflationary policy and that as the years go by there will be more of that in terms of volume and less in terms of price. That is basically the way we project the revenue figures ahead for our

normal work in the department. We have not made a special projection for the White Paper itself.

Senator Phillips (Rigaud): Therefore we do not have a projected GNP for the next five years contemplated by this White Paper?

Mr. Bryce: No sir, we thought it would be clearer for the committees to have them based on 1969 magnitude.

Senator Phillips (Rigaud): I agree with that, but I am considering the future in relation to increasing revenues. I will come to that, but this committee would have been helped by projections for GNP over the next five years.

Are there any studies in the department with respect to the proposed effect of this Paper on the possible reduction of foreign capital that will be coming into this country on capital account? I am not speaking of trade movements that affect the dollars moving in and out, but I am thinking of capital entering Canada for investment purposes. The country on capital account. What is the result of the proposed legislation, if implemented, in terms of its effect on the slowing down of foreign capital coming in and on the acceleration of domestic capital going out? Is there such a study and, if so, would you be in a position to file it with us?

Mr. Bryce: If there were such a study we probably would not wish to file it, because these documents were not prepared for that purpose. In fact, we had considerable discussion in the department on this subject when we were doing work on chapter 8. Our conclusions and arguments concerning it are to be found in several paragraphs of that chapter, notably paragraphs 8.47 and 8.50, where we set forth what we expect and why we expect it. It would be misleading to try and be highly quantitative and set accurate figures on these impacts. It is perfectly obvious from the nature of them that they rest on substantial judgment of how investors in particular are going to react to these proposals under circumstances which will exist at the time they come into effect and continue to take effect. These are novel proposals. It is difficult to make the judgments as to how new tax proposals will in fact affect the flow of investment, particularly international investment. We have tried to apply the best judgement we could to this, bearing in mind the nature of the change. I think it would be pretentious to try to state precise figures.

Senator Phillips (Rigaud): May I again press the point. I am not pressing that they be filed. I am merely asking this question for consideration. Are there such studies on this subject matter in the department, and if there are such studies will you consider the propriety or the desirability as a matter of policy, or other considerations, of such studies being filed with this committee? I do not expect an answer now. I am simply putting that request on record. I want to know whether there are such studies, and if there are such studies will you file them? I could understand you in due course saying that there are such studies and you are instructed not to file them, but I want to know whether there are such studies.

The Chairman: I would like to know whether there is any instruction not to file them.

Mr. Bryce: The studies that are there—and I would have to look to see precisely what they are—are mostly memoranda addressed to myself from my officers. They were certainly not prepared to be filed. Some of them I do not agree with.

Senator Beaubien: Would you only file the ones you agree with?

Mr. Bryce: The general practice is not to publish internal statements. We did have and publish—I do not know whether they were tabled in the Senate; I believe they were in the Commons—studies largely concerned with inflation, savings and some of the investment proposals, prepared for us by the Institute for the Quantitative Analysis of Social and Economic Policy of the University of Toronto. We would be glad to table those studies.

The Chairman: Just to follow that up, I understand you to say that some of these studies were factors that were considered and entered into the calculations and decisions that you made that are now reflected in the White Paper.

Mr. Bryce: Yes, sir.

Senator Phillips (Rigaud): I am asking you to consider the question, and you may deal with it in due course. The next question I would like to put to you is this. I would direct your attention to page 7 of the White Paper. I will ask my colleagues to bear with me for a short while. On page 7, in paragraph 1.15 it says:

> A final important goal for tax reform in Canada must be its appeal to provin-

cial governments and legislatures as a system they too can use. In our federal structure of government we are striving for harmony in federal and provincial tax policies and practices.

Would you now be good enough to direct your attention to chapter 8. The last sentence of paragraph 8.2 reads as follows, dealing with the provinces and the figures to which you refer in your tables:

> They have been prepared on the basis that the provinces do not change the relative proportion of their personal income taxes to federal income taxes, or their rates of corporate income tax.

As I read this White Paper, in the laudable search for symmetry in the future we are assuming co-operation from the provinces, because your figure of $11 billion in 1969 on federal and provincial account and increased taxation of five per cent are based on co-operation with the provinces. Rightly or wrongly, I read in the press that there seems to be some reaction from the provinces, either from their prime ministers or their ministers of finance, that there is not exactly a honeymoon going on in respect of their reactions to this White Paper. I am wondering, in view of the reference to the provinces in the White Paper and to the necessity for co-ordination, integration, co-operation and the like, whether we are carrying on wisely in considering the proposed changes in our laws generally when we seem to know at this stage that the provinces are less than enthusiastic in their reactions to this White Paper.

Mr. Bryce: This is an important issue. The government has made clear in the White Paper its desire to discuss the proposals with the provinces. We have already had some discussions, at the time they were published and are meeting in December, I think it was. We are meeting again with the provinces early next week to discuss this further, and I have no doubt we will have further discussions subsequent to that.

The Chairman: Mr. Bryce, could I interrupt you right there for one moment. Am I right in concluding that the provinces are being asked to consider this White Paper as a *de facto* thing which they will either be asked to accept or decline to accept? Is that right?

Mr. Bryce: Oh no, sir. The minister has expressed his willingness to consider their views and suggestions concerning it.

The Chairman: Then what would be the overall effect on the statements you have made in the White Paper if there are material changes made as a result of conferences with the provinces?

Mr. Bryce: We would, of course, have to study what those effects would be in deciding which of the changes should be accepted and which should not. This is a system which in terms of structure and in terms of revenue is inter-related. We cannot change this and nothing else, or change that and nothing else. I would hope that this committee of the Senate, when it considers whether it wants to propose changes, would also want to look at what is necessary to balance up the system in terms of revenue and in terms of structure. We face the same thing with the provinces. One has to envisage any modifications as balanced in a way that will keep the thing as a coherent whole, both in terms of structure and in terms of revenue. We have already received some suggestions from the provinces; not too many specific suggestions, but general observations so far. We will be discussing them with the provinces, and also further suggestions that we expect they will make after detailed study of the proposal.

Senator Phillips (Rigaud): Is it not an Alice in Wonderland situation, where you are going to get the taxpayers of the country to present a number of briefs, on invitation, on the basis of this White Paper and on the assumption of implementation by legislation thereof, when we know, in the nature of the case, that there will be likely a revision substantial or otherwise, having regard to these provincial reactions. It becomes very difficult to become judicial in dealing with the subject matter.

Mr. Bryce: The problem here is, as the Minister has indicated, the Government wishes not to introduce legislation until there has been ample opportunity for discussion by the public, by Parliament and by the provinces.

Senator Phillips (Rigaud): Yes.

Mr. Bryce: We have to envisage those discussions running along side by side to some degree. Out of that, we would hope that Parliament will take note of the public discussion, and I hope that Parliament will take note of all the provincial proposals; so that when Parliament and the Government reach decisions as to what is to be done, they will reflect that type of consideration.

Senator Phillips (Rigaud): Thank you, Mr. Bryce, I have only two more questions. I am sure my colleagues will be relieved. The first one is the following.

The Chairman: I just want to interject. It is quite likely, then, is it not, Mr. Bryce, that we may find ourselves in the position, depending on the result of the conferences with the provinces, that we may have to make a restudy of the White Paper?

Mr. Bryce: We hope, sir, that before you conclude your study on the White Paper you will have knowledge of the provincial views in some detail and that that can be taken into account when the committee reaches its views as to what, in the light of the evidence it has heard, the briefs it has received, it feels should be done.

The Chairman: No. What I am getting at is that the submissions we will have received will be based on the White Paper and our consideration will involve a consideration and a weighing of the submissions in relation to what is in the White Paper. Now, if we are going to be presented with a varying context, do we go back to those people and ask them for their views or do we go ahead and just exercise our own judgment?

Mr. Bryce: I appreciate the committee is approaching this problem in a quasi-judicial spirit. However, I assume that they can take in all things other than what are presented formally before them in briefs.

The Chairman: We can use our own judgment.

Mr. Bryce: That is right. I do not think the provinces will be hesitant about expressing their views, in a manner in which the committee can hear.

The Chairman: We might invite them to appear.

Mr. Bryce: That would be a matter for the committee.

Senator Phillips (Rigaud): Mr. Bryce, in the White Paper the ultimate rate of taxation contemplated by the schedules is 50 per cent. With your training and background, and being familiar with what has been said by the late Mr. Keynes. About the desired flexibility of tax rates in the light of adjusting income tax, having regard to economic conditions at a given moment, with the consequent budgetary results and the like, I am wondering why it was thought necessary by the department to put yourselves in the straitjacket of reaching the 50 per cent rate now in this proposed White Paper, thereby presumably making it difficult for future Ministers of Finance—or for Ministers of Finance in future years—to adjust their tax structure. It would have appeared to me— I may be completely wrong—that 50 per cent should be your maximum rate and indeed the entire format of the White Paper is based upon this basic thought and this to include capital gains. Should we not start at lower rates? One does not and should not reach the maximum at the start. May we have guidance on that point?

Mr. Bryce: That is a very good question.

Senator Phillips (Rigaud): It is the first one that you have described as a good question.

The Chairman: This one was good: the others were provocative and, it may be, a little embarrassing. I do not know.

Mr. Bryce: Provocative—and embarrassing, too. The Government feels, and it states in the form of a White Paper, that there should be an upper limit on maximum rates. That is in Chapter 8, paragraph 8.36. In doing so, it really accepted the views of the Royal Commission on Taxation in that respect. I would put it this way, that the essence of the situation, is that in our present income tax and what has existed for many years there have been imperfections, loopholes, types of income left out, and higher rates than the 50 per cent or thereabouts were tolerable economically, because in fact they did not apply, in any case. People found ways of getting their income or the equivalent of income in other forms.

What is proposed in this White Paper is intended to make the income tax as effective as we can make it. Given that, we have to re-examine what top rates are economically tolerable. It is that conclusion that is reflected in what the royal commission said and the decision the royal commission reached and which is quoted here, and the decision the Government has reached.

This is a very difficult social and economic issue, but I would say it is a very important part of these proposals. If one is going to have a really effective income tax, then I think it is much more incumbent on Parliament to reach a judgment as to what is an economically tolerable top rate, than it has been before.

This is a very difficult judgment. You cannot run it off on a computer and say that this is what you want. This is a matter of judging how men are going to behave.

The Chairman: What factors do you weigh?

Senator Phillips (Rigaud): Does that mean that the suggestion is that if we take the over-all White Paper and we are assured of a maximum 50 per cent rate, that that is tantamount to a constitutional protection for the citizen, binding on Ministers of Finance?

Mr. Bryce: I do not think you can regard it as equivalent to a constitutional limitation. It is the limitation that will emerge out of economic considerations considered by Parliament from time to time and by governments from time to time. It is quite important, if these proposals go through, that Canadians, and those who invest in Canada, will have some reasonable expectation that this aspect of it will be reasonably stable. I do not think people can expect constitutional guarantees. It has to depend on the judgment of future governments and parliaments.

The Chairman: Senator Phillips, I interjected a question there, and I was wondering if Mr. Bryce has an answer. I asked, what were the factors that you consider in making your judgment decision, that 50 per cent was a good top rate, at present.

Mr. Bryce: First of all, we studied what the royal commission did, and we can give you the various references, if the honourable senators wish to review that. Secondly, we looked up what others in other countries have said about this. We tried to take into account the many briefs that we received and the observations that we got on the royal commissions report. We hear a good deal from taxpayers, as you may imagine, directly, both in writing and orally. We endeavour to consider how they react. In addition, there is another feature which the minister has stressed on a number of occasions and that is the necessity to keep the top personal rates reasonably close to the corporate rate, because otherwise you have the very substantial inducement for people to accumulate funds in corporate retentions rather than bring them out even under the system of gross-up and credit that we have proposed.

The Chairman: Was it not suggested that the 50 per cent rate for personal income tax seemed to be a good rate because you were increasing the base on individuals which would be subject to tax by bringing in capital gains and, therefore, you would be likely to recover at least the same amount of tax revenue?

Mr. Bryce: That was hardly the reason that we chose the 50 per cent.

The Chairman: Is that not stated somewhere in the White Paper?

Mr. Bryce: Well, the fact that we were bringing in capital gains, of course, was the main feature that gave rise to the initial point that I made, sir, that we were making the whole system much more effective in ensuring that income was taxed. In that way that was a most important thing, but we have, after settling on the 50 per cent, then constructed a rate schedule taking all the other changes as well into account that will yield up as close as we can make it to the current level of revenue.

The Chairman: In the White Paper you state that a 50 per cent corporate rate appears on balance to be the highest corporate rate that should be imposed in Canada in order to maintain the competitive position of Canadian industry.

Mr. Bryce: Yes, sir.

The Chairman: Are you prepared to make that kind of statement in relation to the 50 per cent personal income tax rate?

Mr. Bryce: In so far as personal rate should be tied in, as Mr. Benson has suggested, to the corporate rate, that follows. In so far as the other considerations that I spoke of are concerned, it is not as closely related to the international comparison. It has some bearing on it, because if you have a highly effective system that cannot be readily evaded, as we have suggested, and you have top personal rates that are too high, you are more likely to drive wealthy individuals out of the country.

Senator Phillips (Rigaud): And in addition to that there is the brain drain and so forth.

Senator Molson: Mr. Chairman, Mr. Bryce mentioned social and economic considerations. May I ask him if the aim of this whole structure of taxation is primarily to adjust and arrange the financial affairs of companies or is there a social purpose that is paramount in its formation?

Mr. Bryce: We have in Chapter 1 tried to be explicit about the objectives.

Senator Molson: I looked at Chapter 1, but I am still asking my question.

Mr. Bryce: I can understand that anyone would, sir, particularly one who had looked at it carefully. The problem here is to judge the weight of several conflicting considerations. The desirability of having the income tax equitable is not just a social one; but, if you are going to have people work effectively under the tax system, I think they have to regard it as fair as between one person and another, specifically as between those who have comparable incomes and as between those who have higher or lesser incomes.

We have had throughout to try to weigh up the effects on savings and on incentives with the effects on equity. There is no formula that one can easily turn to. The maximum figure for the top rate is one of those which we have introduced to help make this more equitable and heavier system workable and economic. Other ones are the various types of allowances that are set forth in Chapter 2, where we try to take some account, for example, of employment expenses; the provisions for capital deductions of capital losses and things like that are brought in to try to make the whole thing balanced and effective as well.

One would have to discuss this in terms of individual cases, individual proposals, to illustrate the argument effectively, but it has been difficult to reach a sensible judgment on exactly where you should let either equity or difficulties of administration or compliance outweigh economic considerations or vice versa.

Senator Leonard: Mr. Bryce, in connection with the 50 per cent maximum and the effect of making the provincial share a percentage of the federal tax, do you think this effectively puts a ceiling also on the provincial tax where it is to be collected by the federal Government?

Mr. Bryce: We would hope, sir—I would hope anyway that the same arguments that will appeal to Parliament on this score will also appeal to the provincial governments and legislatures.

Senator Leonard: We can all hope that.

Mr. Bryce: Whether we can predict this or whether we can expect it with confidence is difficult to know. Sure, it's difficult, but this is one aspect on which we plan to be as persuasive as we can with the provinces.

The Chairman: Of course you are wrestling with the predominating principle: the need for money.

Mr. Bryce: In the old, homely phrase, we don't want to kill the goose; and the provinces have that incentive just as much as we do.

Senator Phillips (Rigaud): The goose may not be killed, but it is bleeding, Mr. Bryce.

Senator Molson: It is badly bruised.

Mr. Bryce: Just to finish answering your question about the maximum rate, Senator Phillips (Rigaud), how then, if we have that maximum, do we adjust taxes for economic purposes from year to year? I think that can be done in two ways. First, you can make proportionate adjustments up and down without greatly exceeding the 50 per cent rate, although you have to be careful not to creep up and up. Another way of doing it is to regard the rate as a hinge and increase the curve below that hinge. You then have to accept that limit as a constraint, which means that when you increase your taxes to restrict spending—for that is the reason one would increase them; it would be for economic reasons—it is the people below the maximum rate who really do the bulk of the spending and that is where you would go to get it.

Senator Phillips (Rigaud): It would be interesting to provide for your longevity, Mr. Bryce, so that this observation of yours would be there to haunt you if you remained Deputy Minister, because sooner or later the rate will go beyond that maximum of 50 per cent.

The Chairman: It may not go beyond it, but the results will be the same.

Senator Phillips (Rigaud): Sooner or later the rates will go away above that figure of 50 per cent.

The Chairman: Actually, Senator Phillips, the 50 per cent rate could remain constant, but it could be applied lower down the scale.

Senator Phillips (Rigaud): Yes, and the net result could be that you would get rates in excess of that.

Now, Mr. Bryce, would you be good enough to turn to the first page of the White Paper,

that is to paragraph 1.3 on page 5. It says there:

> The needs of the federal and provincial governments for money to do useful and important things are so great that we cannot now afford to reduce the over-all revenues from personal and corporate income tax.

I read that sentence with considerable excitement until I completed the reading of the White Paper and in particular read chapter 8. There I take as an example paragraph 8.41 where we end up with increased taxes, or as it is put somewhat differently in the brief, reduced savings of a sum in excess of $500 million in the fifth year and a sum of approximately $160 million in the first year are anticipated. Now before I submit some material for your consideration, I am wondering if that harmonizes with the statement in paragraph 1.3 that what we are trying to do in this White Paper is to redistribute incidence of taxation. How can that be put forward without the warning being given to us that the net result is an increase in taxation while in paragraph 1.3 you make the statement that you cannot afford to reduce taxation? According to our figures we end up with a reduced saving of $160 million in the first year and a sum in excess of $500 million in the fifth year. Why in the White Paper which announces as your primary objective the redistribution of taxation do we end up with increased taxation if what you say is true that it is not significant? When you consider that the sum of $11 billion in provincial and federal taxes is referred to in one of your paragraphs, it is quite significant when you withdraw from the savings of the people over $600 million in a given year, because this sum according to the schedule which I shall invite you to study involves a credit base for the citizenry of this country of much greater significance. I am referring to this sum in therms of savings and its value when approaching lending institutions to obtain money for the necessary financial expansion in Canada. You and I both know that if we walk into a bank or a lending institution with $600 million in our hands we can get credit of billions of dollars. Therefore the reduction in taxation which you say we cannot afford is met by an increase. The statement has been made that this is an insignificant amount whereas in my humble opinion $600 million siphoned off from the reduced savings of individuals and corporations in one year involves a reduced credit status involving billions of dollars which is a matter of great significance. I would like to ask the chairman now to be good enough to give you a schedule on the last page of which you will see that the total tax yield in the first year show an increase of $160 million and in the fifth year $630 million. Now, my question is double-barrelled; why increase our taxes when the indication is that you cannot afford reductions and why emphasize the insignificance of $630 million in the fifth year in relation to the economy of Canada and its urgent needs.

Mr. Bryce: Well, that is indeed a large question.

The Chairman: Before you answer, Mr. Bryce, I think we should call your attention to the fact that this schedule has been compiled from various paragraphs and figures contained in the White Paper and in each instance given you will find the particular quote and a reference to the particular paragraph and how those figures were used in arriving at this computation. You will find it deals with proposals that reduce individual taxes and that increase revenues, and you will find the same treatment with respect to corporations and non-residents. In each case, as I say, you will find reference to a particular paragraph in the White Paper in support of the figures used to do with this computing job. We think these figures are accurate. Mr. Gilmour who authored this schedule gives us that assurance and we have every confidence in him.

Mr. Bryce: Well, sir, first I would not want to try to take issue with the figures until I had gone through them carefully, but I would first distinguish between the objective as set out here in paragraph 1.3 which Senator Phillips referred to and the figures set out in chapter 8. What paragraph 1.3 says is that we cannot afford to reduce our overall revenues. Now, that is the basic objective we started out with and applied, I think, with fair accuracy in regard to personal tax. If you look at table 15 on page 95 which gives the revenue effects of personal income tax changes on the basis of 1969 incomes, you will see that in our calculations we end up with, in the first year, a reduction of $35 million based on the 1969 figures, and in the fifth year an increase of $70 million based on those figures. Those are changes of less than 1 per cent of the total.

The Chairman: But at the end of paragraph 1.3 you say "... we cannot now afford to reduce the over-all revenues from personal and corporate income tax."

Mr. Bryce: We approached it with the feeling that the personal income tax is the fairest tax we have and the best tax we have and that it should not be diminished because of the part it plays in the tax system.

Senator Molson: Did you say "the best tax we have"?

Mr. Bryce: Yes, sir, with respect.

Senator Molson: I was not quite sure.

The Chairman: Is there not something incongruous in identifying those two words so closely together?

Senator Molson: That is how it struck me, Mr. Chairman.

Mr. Bryce: Well, we have really operated fairly within the limit of paragraph 1.3 in regard to personal tax. It would be hard to get any closer than we have done. In the first year we will be somewhat below.

The second question is how we came out on the corporate tax. On the corporate tax we have not changed the rates; the basic rate has remained the same. What we have done is apply in the corporate tax the structural changes we felt were needed on the various grounds that are argued. It leaves us with the results shown in Table 16. That is to say, an increase of corporate tax revenues of $205 million in the first year, or $210 million if you take into account the slightly higher rates of surtax in some of the provinces. That is the figure given in paragraph 8.1. By the fifth year the gain in corporate revenue is increased to $560 million, and one gets to Mr. Gilmour's figures, I take it, by adding the $560 million to the $70 million for the personal tax, and in the fifth year there is no change, on balance, in the withholding taxes. So, those are consistent.

There the question does arise whether in those crcumstances one ought to reduce the overall rate of the corporate tax, and it would be quite open to Parliament and the Government to do that if it is felt that it is the best thing to do with the increase that results from the structural changes; and with regard to those structural changes, as you will note, the chief one is applying the same rate of corporate tax to all corporations.

The Chairman: Right there, in the 50 per cent rate is not there 22 per cent that simply involves a transfer to the provinces?

Mr. Bryce: In the 50 per cent there is an assumed 10 per cent provincial rate. 10 per cent of the 50 per cent is abated to allow for provincial tax.

The Chairman: So the federal corporate rate could be substantially less if you were not making provision for the provinces?

Mr. Bryce: Yes, but it is only realistic to expect there will be some provincial taxes, and in fact they are now more than the 10 per cent, but not a great deal more—1, 2 or 3 per cent added.

Senator Beaubien: Do you not allow for 28 per cent to be abated?

Mr. Bryce: That is the personal tax. It is open to Parliament to reduce the rate, but these figures we have are what emerged from the changes in structure of the taxes and the comprehensiveness of the tax base.

The Chairman: So if we were going to make it come out even, we could arrive at a lower corporate rate?

Mr. Bryce: Yes, that is one way of doing it.

The Chairman: Is that the way you would suggest?

Mr. Bryce: I would not want to suggest that without consulting the minister.

Senator Benidickson: On that point of the provincial take of corporate taxes, Mr. Bryce indicated it varied from province to province. Could we have the variations on the record?

Mr. Bryce: I think perhaps they are already included here.

The Chairman: I thought they were included in the White Paper.

Mr. J. R. Brown, Senior Tax Adviser, Department of Finance: On page 94 the rates that are legislated by the provinces for 1970 are set out in the footnote.

Senator Benidickson: On corporate taxes?

Mr. Brown: Yes, as well as personal.

The Chairman: With leave of the committee, I have a question I was wondering if Mr. Bryce is in a position to answer.

We are told that the effect of the increase in the personal exemptions is to remove 750,000 persons from the tax rolls, and we are told the result in increasing the personal exemptions overall would mean a reduction in tax revenues of about $1 billion. Have you the figure if you apply the increase in personal exemptions only in respect of the 750,000 who would be removed from the tax rolls and you did not apply the benefit of that to all other taxpayers who are going to pay taxes anyway? How much in dollars would be lost in tax revenues in relation to the 750,000?

Mr. Bryce: It would be a very small loss, relatively. I would like Mr. Brown to answer that, if you do not mind.

The Chairman: Yes.

Mr. Brown: I think it would be in the order of $30 million to $35 million that would be the cost for that particular group of taxpayers. If we were to do that...

The Chairman: I have not asked you the reason yet.

Mr. Brown: I am sorry.

The Chairman: I will come to that.

Mr. Brown: That is a "Yes, but..." question, sir.

The Chairman: Any time you feel I am encroaching on your flow of language, you tell me and I will let you go ahead.

You have, as part of this plan for recouping the loss in taxes, announced you are increasing the tax rates in the groupings which you would call the middle-income groupings, is that not right?

Mr. Bryce: Yes.

The Chairman: So the middle-income groupings take the benefit of the increased personal exemption and then pay taxes at a higher rate?

Mr. Bryce: Yes.

The Chairman: Does not that seem to be a little bit of an exercise in futility? Would it not be better to give the benefits where we are able to and where the minister has stressed in all his public utterances? We are taking 750,000 people off the tax rolls. We take them off and find the $30 million or $35 million to make up for them.

Mr. Bryce: We would be left with a most awkward structure.

The Chairman: Why?

Mr. Bryce: Because we would have a very high marginal rate immediately above those levels, if we did nothing else. We would have to do something else.

The Chairman: Do you mean, to find the $30 million or the $35 million?

Mr. Bryce: To cover the transition.

Mr. Brown: If you said a person whose income was below $1,400 would have an exemption of $1,400 but a person whose income was slightly above $1,400 would have an exemption of $1,000, you obviously would on the first dollar over $1,400 be levying the whole of the tax that the schedule would otherwise levy on the first $400 of taxable income.

The Chairman: You would have to have a dollar limit of income because the personal exemption is not really being increased from $1,000 for a single person to $1,400, because on top of that he gets $100 medical deduction and $150 employment expense, so you have a figure of $1,650. I am not quarrelling with that. I want to make it perfectly clear that this personal exemption in this area is a good thing and I am heartily in favour of it, but I am wondering why we have to lean so heavily on the middle groupings by reason of extending personal exemptions to the middle groupings and then taxing them at higher rates.

Mr. Brown: Perhaps I should have used higher figures to illustrate my point. Nevertheless, if we consider the position of the two people who were at $1,650 and $1,651, I am sure Parliament would not want that extra dollar to occasion a tax of some $50 or $60. Consequently, I am sure that Parliament would want some smoothing of the effect of the taxation just immediately above the exemption levels.

The Chairman: Yes, but with your acknowledged ability, you could do it.

Mr. Brown: Thank you. We certainly could, but we are no longer talking of the $30 million to $35 million cost. I think that this should be mentioned too, that the objective was also to give relief to those people who were somewhat above the $1,400 level up to

the $3,000 to $3,500 level. We have in the department an analysis of Table 15, which is the one which gives the revenue changes that result from the 13 more important proposals in the White Paper. We have an analysis in the department of the effect of these 13 changes on the various income groups, beginning with incomes from zero to $1,000 a year, and then working up. Perhaps it would be helpful if we filed a copy of that.

The Chairman: Yes, I would like to see it.

Mr. Brown: When you get that you will see the relationship between the first and second proposals mentioned here, the first being the change in exemptions, and the second being the rate schedule change. You will see that the benefits extend—and this is explained in narrative form, but the figures make it a little more dramatic—considerably beyond $1,400.

The Chairman: But you have a $2,800 exemption for the married person and you also have the $100 and the $150 there, so you are up to $3,050, and he might have some deductions for dependants which would take it even higher. It strikes me, as I have described it, that it is an exercise in futility to give an increase in personal exemptions when for that same person you are increasing his tax rate because of the fact you have included him in that gift. That is a strange kind of gift to give him.

Senator Leonard: I think your point is illustrated by table 15 which is on page 95. Compared to the $35 million, what is lost by reason of the increase in exemptions at the exemption level only, going right through the whole schedule, is $1 billion, and that is picked up by an increase in the rates, to get a net addition of $255 million.

The Chairman: That is right.

Senator Leonard: Your point is that they might start with the reduction of $35 million, and if that was put back then there could be a figure of considerably less than $1 billion.

The Chairman: Yes, and a substantial reduction in the tax rates.

Mr. Brown: There are two or three different technical ways of arriving at a man's tax. Table 5, which is at page 28 of the White Paper, deals with the effect of the new exemptions, the new rate schedule, and the new deduction from employment income on a married taxpayer with no dependants. This is the one you were discussing?

The Chairman: Yes.

Mr. Brown: As you can see, at the $3,000 level the man's tax decreases from $133 to $2, but when we look at the man at the $4,000 level we see that his tax has decreased overall from $331 to $219.

This is the effect of two things at work. One is the increased exemptions, and the other, which works in the opposite direction, is the increased rate structure. The net of the two constitutes a reduction in tax for the man at the $4,000 level from $331 to $219.

I do not think the taxpayer minds the way in which it is calculated. It is the $219 that he is interested in. The point that I was referring to earlier is that the Government decided that it would not cut the benefit off at the level where the reduction is $131, and then say to the man at the $3,500 level: "Your taxes will not be reduced."

The Chairman: I am not suggesting that. I am not suggesting that you cut it off, and just recover $35 million, I may have loosely conveyed that opinion to you, but what I am saying is that there must be some place in this schedule where it is unprofitable, and doing a disservice to the taxpayer, to give him the exemption and then increase the tax to make up for the loss in tax revenue.

Mr. Brown: That shows up at the $10,000 income level, where a net of the two is an increase in tax.

The Chairman: Yes.

Mr. Brown: But if there are to be benefits to those lower down, and if the overall revenue is to be the same, then the money has to come from somewhere, and clearly it comes from those higher up the scale.

The Chairman: I am not questioning that. That is a clear statement that no person can question. What I am talking about is the quantum—how much you really need to recover.

Senator Benidickson: Mr. Chairman, Mr. Brown said that the Government had decided something, and I did not follow that too clearly. That does not mean that what is in the White Paper is something that the Government has decided, does it?

Mr. Brown: Senator, I am sorry. I left out two words. I meant to say "had decided to propose".

The Chairman: There is a big difference between "deciding to propose" and "propose".

Senator Carter: May I refer you to Table 16 and to the increase in revenue of $560 million in the fifth year. Is that a total tax yield with the application of the White Paper proposals, or is that a projection of the revenue from the same source from which the $205 came in the first year? I ask that question because over five years the numbers in each group are going to vary.

Mr. Bryce: No, sir, the figure is what the change between the present system and the new system would produce in the fifth year if the numbers of taxpayrs and their incomes, personal and corporate, were the same as in 1969.

Senator Carter: So that with a growth in the economy, and with more people in each group, the total yield would be somewhat greater?

Mr. Bryce: That is right, sir, but if we try to allow for that growth we would be confusing the comparison.

The Chairman: There is another question that has occupied a great deal of public attention, and that is as to the manner in which small businesses are being dealt with in the White Paper proposals. I am referring to the proposal that the 21 per cent on taxable income up to $35,000 be withdrawn, and that those companies be subject to the regular corporate rate. This has certainly produced a storm of protest newspaperwise, and that is because many of the public are raising the issue. I see that that is expected in the first year to produce an additional revenue of $95 million.

Mr. Bryce: Yes, senator.

The Chairman: That is as a result of that change.

Mr. Bryce: Yes.

The Chairman: But your difficulty, as I see it, Mr. Bryce—and I would like to get your view on it—is that the small businessman who is in the category of taxable income of $35,000 or $40,000 is in not as a strong a position creditwise in respect to the financing of his operation as is a larger business, and I think that was the reason originally why the Parliament of Canada put in force those lower rates on a certain amount of taxable income of small businesses. I say unfortunately, and that is my view. The way it has been applied is that every business, whether it had $1 million or $5 million, or whatever it was, of taxable income was entitled to this 21 per cent on the first $35,000. The one who would appear to need it because of its inferior credit position, et cetera, is the one which comes in that low tax income range. It occurred to me, and I would like to have your comment on it, Mr. Bryce, that if we decided that the 21 per cent for small businesses should be continued up to $35,000 of income, but realizing that you cannot draw a fine line there, you would say that any business whose net income is not in excess of $100,000 shall be entitled to the 21 per cent on the first $35,000. In excess of $100,000 it is subject to the full corporate rate.

Mr. Bryce: If Parliament wanted to accomplish that objective I am sure one could devise a formula and law which could do it. It may be that, just as with the personal tax, you would want to phase it out more gradually as the income increased. There would not be an abrupt transition. That, however, is not the most difficult question. It is whether those with profits of $35,000 or less, or slightly more, should get this or the kind of treatment that has been proposed here.

The Chairman: With regard to that very point, what would be the result if you did what I suggested! Let us assume that a man with a small business and $35,000 taxable income pays the 21 per cent rate so that he is below the 50 per cent rate by 20 per cent, which means that he would keep about $10,000 plus in the year. If you decided you were going to phase out this special treatment over a period of ten years, he would have been in a position to accumulate his working capital to the extent of $100,000.

Mr. Bryce: Do you mean you would give each small business ten years in which to start?

The Chairman: Yes.

Mr. Bryce: Clearly that would be a different kind of proposal to what we have here.

The Chairman: Of course it is.

Mr. Bryce: We have proposed a five year transition for the existing businesses, whether new or old. That would enable them to accumulate a certain amount of capital.

The Chairman: And establish their credit.

Mr. Bryce: Yes. One would have to discuss whether this would be fair or economically desirable. Basically what we have proposed in the White Paper is that the proprietor, owner or shareholder of a small corporation, assuming that it is not a widely-held corporation, because it could hardly be such, would not be taxed twice. He would pay only the personal rate on whatever his profits were out of that business, or left in it and treated either on the partnership option that is proposed here or brought out in the form of stock dividends to shareholders. The question is whether one ought to give the small business what is in effect a subsidy by taxing it less, or should it be given some sort of loan by deferring its tax, or other preferential treatment that individual proprietors, partnerships or people receiving income from other sources do not get. The case for favouring the small business has to be made on economic grounds if one is not going to adopt something similar to the proposals here.

The Chairman: Economic grounds or economic necessity.

Mr. Bryce: Economic necessity is certainly economic grounds for doing it.

The Chairman: Or maybe political justification.

Mr. Bryce: Quite. You know, we expected quite a controversy over this issue. It is a very fundamental issue.

The Chairman: But when you call it a subsidy to deal with it in this fashion, what would you call the difference between assessing one man with a certain amount of income at a 25 per cent rate and the next man, with a certain amount more income, at a 30 per cent rate? Why would you not even the rates out? Is there an element of subsidy in the low rates?

Mr. Bryce: Fair enough. What you are proposing here, though, is that some one who operates an incorporated business and receives certain profit and some one who operates a non-incorporated business will pay quite different taxes. If that is going to be the case, one has to be prepared to justify it on some kind of economic or social ground.

The Chairman: But a person who operates a non-incorporated business has the privilege of incorporating.

Mr. Bryce: True, but why require him to incorporate and offer him such a gain for incorporation?

The Chairman: We have done it before.

Mr. Bryce: True, it has been done before and it is carried on.

Senator Molson: Would one justification not be that all big businesses were little businesses once?

Mr. Bryce: Yes sir, but the bulk of small businesses do not become big businesses.

Senator Molson: They could not all become big businesses. There is no room for all little businesses to be big businesses.

Mr. Bryce: Is it right that a person who runs a small business and earns $30,000 out of it should pay substantially less tax than the corporate executive who receives $30,000, or the professional man, or various other people who in one walk of life or another earn $30,000? One has to examine what reason there is for favouring the small business.

The Chairman: Do we re-examine?

Mr. Bryce: Re-examine.

The Chairman: Because we did examine and we did pass it into law.

Mr. Bryce: True. As I remember, it started back in the late forties, when the basic corporate rate was lower. The difference was 10 per cent to start with an went up to 20 per cent later, then 21 per cent.

The Chairman: So we have to assume that Parliament may not be as intelligently advised, or may not have been then? Do we assume that there really was not any economic justification for what was done and you are now saying there is such justification for making the change?

Mr. Bryce: What we are saying now is that we have not seen the economic justification or necessity for continuing this rate.

The Chairman: That is challenging the judgment of Parliament, I suppose.

Mr. Bryce: Well, times change and Parliament changes.

The Chairman: Parties change and people change.

Mr. Bryce: It was the same party, as I recall.

Senator Benidickson: We have not reached the point where under the proposals in the White Paper and in the Carter Commission there are benefits to those who receive dividends from corporations in the form of a set-off on their personal income tax, but we have not come to that yet. That would apply to small business corporations tax as well as to larger corporations tax. We have to examine the effects of that.

The Chairman: We propose to cover every phase of the White Paper. We realize we are not going to do it this morning, so Mr. Bryce can expect another invitation.

Senator Benidickson: But you were referring to the unincorporated businessman earning a certain income.

The Chairman: No, Mr. Bryce was referring to the unincorporated.

Senator Benidickson: Vis-à-vis the incorporated businessman who presumably controls his company and was the beneficiary of what his company was doing. That has to be dealt with.

The Chairman: Oh yes. We have not got to that. There are many things here that we have not got to yet, but we will in due course.

Senator Hays: Mr. Chairman, may I ask a question?

The Chairman: Yes.

Senator Hays: Did I understand the deputy minister to say that there was a difference between the small company that was incorporated and one that was not, that this was unfair and one of the reasons why he felt there should be a change?

The Chairman: I thought that was what he said, and I think that is what the White Paper says.

Senator Hays: This is what you said?

Mr. Bryce: Yes.

Senator Hays: That this is unfair?

Mr. Bryce: Yes, and this is what the minister has said.

Senator Benidickson: This was not particularly Mr. Carter's recommendation was it?

Mr. Bryce: The royal commission recommended some special capital cost allowance for new and small risk businesses.

The Chairman: Are you satisfied with the answer?

Senator Hays: Yes.

The Chairman: Are there any other questions? I was just going to refer, Mr. Bryce, for your examination, to the reasons which you give in chapter 4, paragraph 4.18 for taking away this 21 per cent. Some of them I find almost amusing. One reason is the delay in collecting the second instalment of tax. A small company pays 21 per cent tax, which is the total corporate rate, and there is not any second instalment. The only other tax is if there is a dividend on which the individual pays.

Mr. Bryce: Yes.

The Chairman: So it is improper to describe it as a second instalment of tax.

Mr. Bryce: In our proposals here we have been looking generally at the two stages; that is, what is taxed at the corporate level and then what is taxed at the individual level.

Senator Phillips (Rigaud): If honourable senators are not at the moment ready to ask further questions, I should like to put one further question on this particular aspect. The intention, of course, is not now to go into the details of the White Paper this morning, as we indicated, and you will remember that I said at the beginning that we will deal with the biting mustard in the sandwich in due course. There is one aspect of the second instalment on tax take through dividends that I would like to discuss with you. Clearly the White Paper contemplates the desire of the fiscus to deal with corporate taxation but it also desires to bring about a distribution of dividends so that you get further tax yield through dividend distribution. The issue of distribution of profits goes to the whole inflationary question that I mentioned previously, because a declaration of dividends involves the increased purchasing power of the share-

holder recipients, and I hope there has been some study in connection therewith.

It is pretty clear that this White Paper says to the people of Canada, "We are not wanting to tax only corporate profits, but we think it is good business for corporations to distribute profits to their shareholders." From the point of view of the tax benefits resulting from the declaration of dividends in certain instances, there are some of us who feel that is a form of corporate profligacy to distribute profits which are required for bad times or for expansion. I will not now enter into a discussion with you on that point, because this is hardly the place to do it, but I would like to draw your attention to this.

Years ago, in the old Income War Tax Act we had the famous section 13 dealing with the ability of the Minister of National Revenue to cause corporations to distribute dividends if they were being unduly withheld and for no good cause. On a personal basis, I remember discussing this matter with the late Mr. Carter, who preceded me as President of the Canadian Tax Foundation, where I had the honour of following him. For some years we felt that in dealing with the distribution of corporate profits this was a sound section, that there are certain corporations that require their profit for expansion, but there are other corporations who are greedy and sit on it and do not distribute it to the shareholders, but they have no right to sit on it and bring about further additions and accretions of capital, thereby bringing about disparity in the economic wealth of people in the community. All that is agreed.

The minister then had the right to study the individual balance sheet to see if the surpluses, whether capital surpluses (which was the position at that time) or undistributed earnings, were not needed, and if he came to that conclusion he could cause distribution to be made. For years the Department of National Revenue recogized, as presumably did the Department of Finance, that there was a distinction between the needs of corporations having regard to their activities—holding companies, operating companies, manufacturing companies, risk capital companies, exploration companies and the like—and they decided to study each individual case *ad hoc*. It was not difficult to apply the section. However, the department became lackadaisical in applying the section and said, "Let's not bother with this sort of thing. It's a nuisance. It is ending up in discrimination. We do not have time to study the needs of individual corporations. Let us therefore bring about the repeal of this section." In due course the section was given an almost indecent burial.

We have not touched today on the whole revolutionary approach in the White Paper to the handling of credits for individuals on dividends and the relationship to corporate profits, which in itself involves the question of distribution of surpluses. At this stage of my thinking I will possibly raise this matter in the committee as a recommendation. In my humble opinion the simplest way of dealing with the problem of the second bite on taxation after the corporate rate would be the reintroduction of a section, like the old section 13, with teeth, with the necessary personnel to deal with it, so that there would be an equitable, fair and scientific distribution of any un-needed surpluses. This would bring about two things: first, a greater increase to the shareholders in respect of their investment; secondly, an increase in revenue to the fiscus.

Mr. Bryce: We could consider that, and we will certainly make comments and be prepared for questions on it.

Senator Phillips (Rigaud): You might find it very interesting, if the records are still around, to discover why that section was repealed. I am older than you and Mr. Brown. When they were repealed, my understanding is that they were repealed because the personnel was not available to deal with it. I have always felt that if I am scratching my left ear I like to scratch it with my left hand and if I am scratching my right ear I like to scratch it with my right hand. As against the involved method in the White Paper, the reintroduction of Section 13, properly handled and modernized, might do the trick.

Mr. Bryce: Would it not have a tremendous effect surely, that would do more to reduce corporate savings than anything in the White Paper?

Senator Phillips (Rigaud): If that were possible.

Mr. Bryce: Yes.

Senator Phillips (Rigaud): My view is this. We should keep in mind corporations that require retention of profits for credit or other purposes as against those who should not

have the right to accumulate surpluses that are not really required and that have the effect of excessive and unequitable retention of wealth.

Mr. Brown: We did discuss with National Revenue briefly why this section was repealed. Basically, the reason was this. It was found very, very difficult to distinguish between the cases where the reinvestment of the funds was appropriate and those cases where the re-investment of the funds was not appropriate. It is an appropriate re-investment or normally seems to be so, if it is to be in bricks and mortar for the expansion of a particular business, but a very difficult time comes when money is put in investments.

I happen to have in my briefcase an extract from the publication of the CALVRA of statistics on the families of corporations. The two pages I have with me happen to deal with the family of companies controlled directly or indirectly by Noranda Mines. It takes up almost two pages of that publication. That is Noranda Mines and their subsidiaries as they are reported to CALVRA and reported in the published statistics.

If you look at Noranda's listing you would find investments in some 24, 25 to 30 other companies. It is very hard to distinguish their investments in other companies, from, say, through J. R. Brown Inc.'s investments in other companies, and to decide who was making an appropriate investment and who is not making an appropriate investment.

This was the reason, or one of the reasons, why it was repealed. The other was pressure from taxpayer groups, that they did not like the Minister of National Revenue and his officials to have this wide a range of discretion, they thought there ought to be a rule of law. There was an inside reason. It was that they just found it very difficult to deal with cases where the money had been used and put into investments.

The Chairman: Mr. Brown, in other areas in the White Paper you have not backed away from dealing with a problem even when you admit that it is difficult to administer and very complex.

Mr. Brown: That is very true, Mr. Chairman, but I think that throughout the White Paper there has been an attempt not to introduce ministerial discretion. There has been an attempt to get away from ministerial discretion and stick to the rule of law—and this I think ties in with the answer I have given.

Senator Everett: Mr. Bryce, in imposing a 50 per cent tax on capital gains on closely held corporations, as opposed to a 25 per cent tax on the gains on shares of widely held corporations...

Mr. Bryce: These are maximum rates.

Senator Everett: Yes, dealing with the individual, that is right. How do you, first of all, justify the difference between the two classes of shares? What was your overall purpose? Was it to force or induce closely held corporations to become widely held corporations? and will it not cause capital to flow away from the shares of closely held corporations into the shares of widely held corporations, so that, in time, you will not have the middle size of closely held corporation and all you will have in Canada is the small number of very large and widely held corporations.

Senator Benidickson: Before Mr. Bryce answers, may I ask Senator Everett in somewhat different terms? Are you thinking about private companies and the public stock exchange?

The Chairman: No, in the White Paper they talk about closely held companies and widely held companies.

Senator Benidickson: The same phrases that Senator Everett has used?

The Chairman: Yes, but ordinarily the closely held company would be, I think, what we call a private company in law—although there is discretion in the minister—he can decide the classifications on the number of shareholders, etc.

Senator Benidickson: That is why I asked.

Mr. Bryce: This is a major point and a complicated point. We do not feel that we are favouring the widely held companies but rather the closely held companies. In the case of the closely company the whole of the corporate tax is given as a credit towards the personal tax. In the case of the widely held companies, only half of the corporate tax is given as a credit to the personal tax, on dividend. So there is an unintegrated 25 per cent corporate tax on the widely held companies that does not apply to the closely held companies. If you look broadly over the life of the corporation, we are treating the closely held

corporations, and the small corporations would normally fall in that category, more favourably than the widely held corporations.

The reasons for doing that are explained in Chapter 4. This is a new distinction. I believe other countries do not make it and it is in effect a radically new idea, and...

Senator Everett: I am sorry. On the one point you raised, I just wonder why the shareholders of closely held corporations are not more closely related to the income of the corporation than are the shareholders of the widely held corporations. We are talking of the flow of capital, which is crucial in this.

Mr. Bryce: We speak of that. We take note of that point in Chapter 4. We have made a distinction, feeling that the shareholders of the closely held corporations are really much closer to the whole operation—and incorporation is really just a way of arranging their affairs.

When you get to the widely held corporation, the public corporation, we are recognizing, in effect, a separate entity, a separate personality, something that has a much more remote relationship to its shareholders. We have felt that that was a legitimate basis for taxing them separately and not giving the full integration.

Senator Benidickson: And give it to the personal income taxpayer?

Mr. Bryce: Full credit to the personal income. On the other hand, we have felt that, in view of the unintegrated corporate tax which the widely held corporation pays, we should make some adjustment on the capital gains tax. That is why we have matched it by taking half the gain only into income.

Mr. Everett: In the widely held?

Mr. Bryce: In the widely held. There are other reasons, too, but in the case of the closely-held corporations we would envisage that most of the accretions of income would be credited to the shareholders or provided to the shareholders with the corporate tax credit through share dividends or something of that sort, so that you would not have the necessity for paying capital gains tax to nearly the same extent that you will have on the widely-held corporations.

The Chairman: Would you develop that a little bit? I wonder why you say that.

Mr. Bryce: Because we permit the credit for corporate tax to be passed through to the shareholder by means of a stock dividend or share dividend.

The Chairman: Yes?

Mr. Bryce: That we assume will be possible in most of these closely-held companies and will be feasible, and they can arrange their affairs to make it feasible, if that needs to be done.

The Chairman: You are talking about capitalizing surplus earnings. Rather than give them in cash dividends you give them in stock dividends.

Mr. Bryce: They will get full credit for corporate tax when that is done.

Senator Everett: Mr. Bryce, would you address yourself to the problem of goodwill and increase in assets in the corporation that cannot be passed out.

Mr. Bryce: We recognize that those are involved, but the accumulating earnings can be passed through to the shareholders.

Senator Everett: The accumulated earnings?

Mr. Bryce: The accumulating earnings.

Senator Everett: The accumulated earnings are not the underlined growth of the assets or the goodwill of the corporation and there is a clear advantage, then, that rests with the widely-held corporation over the closely-held corporation. If we are talking about growth of capital, it seems to me that the advantage does not have to be very great before people will say that instead of putting their income into closely-held corporations, where admittedly they can get a tax credit but still have to pay 50 per cent of their corporate income and another 50 per cent on their gain, they will put their money into widely-held corporations where their absolute upper limit of taxation will be 25 per cent.

Mr. Bryce: But it is not on the dividends.

Senator Everett: Oh, yes, it is.

Mr. Bryce: Well, you only get half the credits.

Senator Everett: Let us take a theoretical situation. I a man puts all his worth into the shares of a Canadian widely-held corporation,

I am suggesting to you that his upper limit of taxation would be 25 per cent.

Senator Beaubien: After five years.

The Chairman: On dividends.

Senator Everett: No. In a widely-held corporation he will pay a maximum of 25 per cent tax on his income, and when he sells his shares, not taking into account the five-year aspect for a moment, when he sells them his maximum capital gain will be 25 per cent. That is a clear indication to people with capital to get out of closely-held corporations and get into widely-held corporations.

Mr. Brown: May I suggest that the same reasoning would indicate that, if he put all his money into closely-held companies, he would pay no tax at all on the yield that came by dividend.

The Chairman: He would get no money.

Mr. Brown: No, assume he got cash dividends.

Senator Everett: You say he would pay no tax?

Mr. Brown: You are referring to the maximum rate on dividends from widely-held companies, and you are thinking of the $16\frac{2}{3}$ figure, I believe.

Senator Everett: I thought we had agreed that there was a relationship between the shareholder in the widely-held corporation and the corporation and between the shareholder of the closely-held corporation and the corporation. Just passing that agreement along, then, that man is more related to the 50 per cent tax the corporation pays.

Mr. Bryce: You are disregarding the corporate tax completely.

Senator Everett: I am saying we have already agreed on that point.

The Chairman: Both classes of companies pay the corporate rate of 50 per cent.

Senator Everett: Correct.

The Chairman: Just what happens after that?

Mr. Brown: The shareholders of the closely-held corporation pay no more tax on the distribution of income after that. A shareholder of the widely-held corporation may pay up to $16\frac{2}{3}$ per cent after that on the distribution of the income.

The Chairman: Are you saying that the dividend distributed by the closely-held corporation is non-taxable to an individual?

Mr. Brown: It is this way, senator: a $100 dividend is reported by him as $200 of income, but he has credit of $100 tax paid by the company so that he has no net tax on it.

The Chairman: Right.

Mr. Brown: Assuming the corporation has paid the tax. The other point is that, when you speak of the attraction of capital, there are closely-held corporations which will always remain closely-held corporations, but one of the main attractions to an outsider in putting his money into a closely-held corporation is the hope that it will grow large enough to go public, and that is when he will really get a large return. The White Paper contemplates that in that situation, once that company has gone public, the shares he has in that company will be taxed at half rates notwithstanding some increase in value that took place before it went public.

Senator Everett: Just to clarify that, if a closely-held corporation goes public, the gain on the shares is affected to the extent that the 25 per cent tax credit applies to that. Is that correct?

Mr. Brown: From then on there would be a half rate that would apply. Or putting it another way, only half the gain of the sale of the shares would come into the income of the shareholder, notwithstanding he was a founding shareholder.

The Chairman: The first step of the closely-held company would have to be to become a widely-held company. They would be classified as that by listing their shares or trading over the counter. Then, once it is in the category of the widely-held company, it starts to get the tax credits.

Senator Everett: Is there an incidence of tax when the closely-held company becomes a widely-held company?

Mr. Brown: No there is not. The credit for the corporate tax paid on subsequent earnings would be reduced from the full credit to half credit, but I was addressing myself to your mention of the attraction to capital to go from closely-held companies to widely-held compa-

nies. There are two types of capital to consider here. One is the capital of the entrepreneur, who, generally speaking, has not too much capital to put into other things because he is going to build his own business first. The second type of capital is that of the person who makes capital available to the man in order to help him grow. One of the things in his mind, I suggest, would be the possibility that the company would grow to the stage where it could go public, in which case he would look forward to having full credit for the corporate tax during the years of growth and then having the half rates when he sold out later. I would have thought that would be some attraction.

Senator Everett: It certainly indicates to me that the policy of the department or of the minister is to induce closely-held corporations to become widely-held corporations; and, to carry it one step further, the department may be opposed to the retention of closely-held corporations.

The Chairman: Senator, I would suggest that it may be the intention of the White Paper, but you must not impute an intention to the minister.

Senator Everett: I am sorry. I apologize.

Mr. Bryce: It may be the implication of the White Paper.

Senator Welch: Is that not tied into the proposal to take away the relatively low income tax of the smaller companies?

The Chairman: The White Paper proposes the removal of the 21 per cent and the imposition of full corporate rate, if that is what you mean.

Senator Welch: It is removing the advantage that small corporations have had with regard to corporate tax rates. Isn't the whole thing tied in together and calculated, frankly, as Senator Everett has said, to more or less force that investor to go into a widely-held corporation?

Mr. Bryce: We don't feel that at all. We feel that on closely-held corporations we are eliminating the two taxes, personal plus corporate. We are removing the duplication so that there will be only the one tax. Those that are free to do so and want to do so can take the partnership option that is proposed and they will pay only the personal tax on that share of the profits. Those that do not do that can pass the earnings out either as cash dividends or as share dividends and get full credit against personal tax for the corporate tax.

Senator Welch: But should they not be building up reserves?

Mr. Bryce: If they do it by share dividends, they can get the credit and build up the reserves so that it is possible for them in that way to arrange their affairs in such away that they can accumulate their profits and pay only one tax at appropriate personal rates of tax.

Senator Benidickson: There is nothing to ease the burden then in the case of closely held companies?

The Chairman: I was going to raise that question because of a point raised in the Commons committee dealing with the effect of the revaluation in five years applying to shares in widely-held companies but which does not apply to shares in closely-held companies. Let me give you an actual illustration; some years ago it was the rage and even the political rage to force companies in Canada, fully owned by foreigners, to expose or offer at least 25 per cent of their shareholdings to the Canadian public.

Mr. Bryce: Yes, I am familiar with that.

The Chairman: You are familiar with that. I am too.

Mr. Bryce: I would say we were inducing rather than forcing.

The Chairman: Well, inducing or forcing—you take your word and I will take mine. Now I have in mind a company which I shall call XYZ, a fully-owned, non-resident company, but a very substantial operating company in Canada. They offered 25 per cent of their shares to the public in Canada and the offering price was $26 per share. If you look at today's market, the price is $13 a share. Now on your proposal, this is now a listed company and is therefore subject to revaluation in five years. This, then, may give rise to the situation that as of valuation day, the value of those shares on the market is $13 or $14. Then in five years' time the market value may be $20 a share. Therefore anything that the holder of a share in that company might make in excess of $14, although he had sub-

scribed $26 per share, would be a taxable gain. Can you justify that?

Senator Benidickson: Yo mean, Mr. Chairman, that he had a capital loss?

The Chairman: No, he would not have a capital loss under the terms of the White Paper.

Senator Benidickson: But the value of his share went down from the subscribed price during the five-year period.

The Chairman: But you don't take the value you start with. You take the market value on valuation day.

Senator Benidickson: That is V day.

The Chairman: V day, D day, VJ day, whatever you want to call it. If the market is up a bit but not up to what it was when you originally bought the share, then you have theoretically a capital gain on which you pay tax.

Senator Benidickson: Although he lost on the overall situation.

Mr. Bryce: That problem arises regardless whether it is a non-resident company or a resident company that sold the shares in the past. We do not propose to go back in regard to shares or anything else of that nature other than bonds or mortgages. We do not propose to go back beyond the valuation day to see what the actual cost of the shares were.

The Chairman: But you have changed your mind with regard to bonds?

Mr. Bryce: Yes, there has been a modest change in that we would count those who had bought bonds between the White Paper day and valuation day so that they can recover their cost just as those who had bought them before White Paper day. That is simply to make it possible for people who had participated in new bond issues to be protected in the same way as those who had bought prior.

The Chairman: But if you take this example which I have given you, you now have a non-resident owning 75 per cent of the issued shares in a widely-held company, and at the end of five years there will be a revaluation and if the market is up that day as against valuation day, the increase will be regarded as a capital gain.

Mr. Bryce: But it is that for any shareholder of any share bought before valuation day. We had to consider this problem and we came to the conclusion that we would not permit people generally to go back and claim protection for any loss they had incurred before valuation day. We are not taxing any gain they made before valuation day. We are trying to avoid any retroactive feature of that kind.

The Chairman: But it is deemed a realization of a profit.

Mr. Bryce: That would apply on the deemed realization in regard to any share that any Canadian taxpayer would hold on valuation day.

The Chairman: But if I have to dump 75 per cent of the issued shares in a company listed on the market in order to get the money to pay this tax, what will happen to the market?

Mr. Bryce: That would be a different problem.

The Chairman: Yes, but a very serious problem.

Mr. Bryce: But the fact remains that we have to start the whole ball game from valuation day. We are not taxing gains made before that date and we are not allowing for losses sustained before that date.

Senator Benidickson: On the basis of the five-year assessment, apparently this is unique in the world-wide picture with respect to capital gains.

The Chairman: Unique is indeed the word to use.

Senator Benidickson: I understood the Deputy Minister was to tell us a little bit about the philosophy behind this today and I would like to know what the idea is behind the philosophy of being different from the practice in the United States on capital gains when disposed of or in the five-year period of assessment in tax.

Mr. Bryce: The chief difference, of course, we have from the United States is that in general capital gains are taxed on the same basis as other income.

The Chairman: Depending how long these shares are held. I mean if they are held over

six months, the capital gain is at a certain rate of tax.

Mr. Bryce: Yes. We are treating them in the same way and the only exception essentially applies in the case of widely-held companies where I made the distinctions I have already spoken of.

The Chairman: But what Senator Benidickson is getting at is the philosophy for establishing a second valuation day and calling any accretion between the first and second valuation days a capital gain whether the shares are sold or not.

Mr. Bryce: I was really just commencing with the general philosophy that we would treat gains like any other income. There are various advantages to that in terms of the system and equity which we need not linger on. Now in regard to share gains we wrestled with the question of what we should do and we wrestled with the question of giving the preferred rate which Senator Everett has spoken about and we came to the conclusion that we did not want to have to tax these on death or deem them to be realized on death as the Royal Commission proposed. We did not want people to be locked in forever. We wanted them to be in a position where they could trade their shares without serious penalty. We thought that in view of the preferred rate on these shares and in view of the marketability of them and the fact that they are taxed at less than income, it would be reasonable to have these valued and the gain in valuation taxed. By definition, so to speak, these are marketable shares; that is what characterizes them.

The Chairman: Well, does it? You can study the list of the Toronto Stock Exchange or the Vancouver Stock Exchange, and because shares are listed and you look at the movement of shares you find some move in a very small volume. If you try to sell 5,000 shares in the market you would depress the price.

Mr. Bryce: No, some are much more marketable than others and the holder will take this into account if he knows he is exposed some years hence to a tax on the increase in value.

The Chairman: This is a spur to sell.

Senator Beaubien: He makes sure he is going to buy something that is not going to go up!

Mr. Bryce: He is not suffering an unreasonable tax on them. It is an unusual occasion on which to pay the tax as compared with others, but we feel it has other advantages, that once he has paid that tax that gain is behind him and he can sell his shares without having to pay tax on the sale.

Senator Molson: But he may be in a position where he wants to hold shares and does not want to sell them.

Senator Benidickson: He does not want to sell, but he is revalued.

Senator Leonard: Is it impracticable to make it optional?

Mr. Bryce: I think so, because there would be a great advantage in many cases to delay.

Senator Leonard: In fact, on the realization basis in the United States he has the option, and sells one day and buys a day or two later.

Mr. Bryce: Yes.

The Chairman: You say so casually that he can find the money, but this may be his only shareholding. It looks like levying on capital.

Mr. Bryce: If any shareholder owns only these shares, clearly he has to anticipate that he will have to realize on some of them or borrow against them in order to pay the gains tax.

Senator Flynn: Would the Government accept payment with those shares?

Senator Molson: This involves quite an implication. This means that it is no longer desirable that companies have any family control in any business.

Mr. Bryce: The minister has mentioned that we are examining these problems that arise on the periodic valuation and taxation.

The Chairman: That is what I was going to ask you.

Mr. Bryce: We will be bringing forward a paper on this which could be made available to this committee as well as to the House of Commons committee.

The Chairman: That is what I was going to ask you. I noticed that the minister mentioned that his position on this point was going to be reduced to a paper and furnished to the Commons committee.

Mr. Bryce: Yes.

The Chairman: I would expect us to get the same generous treatment.

Mr. Bryce: I am sure that if the committee wants it, they will receive it.

The Chairman: Certainly the committee wants it.

Senator Hays: Are you going to start withdrawing little pieces like this as you become more knowledgeable about what you have beeing proposing?

Mr. Bryce: The minister means what he said about willingness to modify these proposals in the light of discussion and study.

Senator Benidickson: And two of the important places are this committee and the House of Commons committee.

Mr. Bryce: Of course.

Senator Hays: There is another question I want to ask. In the first place, I do not like the capital gains tax at all. I think Canada is a very cold, harsh country, and the only people who came here were people who had to have great incentives, and the rest got here via the natural route of increase or they would not be here. I wonder whether the federal Government of your department did—and if you did not, why you did not—take a look at the unearned increment tax which is the privilege of provinces to put in. This has been done in the past in so far as capital gains are concerned.

Mr. Bryce: How would you distinguish the unearned increment from the other?

Senator Hays: Well, we had an unearned increment tax in Alberta for many years on capital gains. It was a 10 per cent unearned increment, which is really a capital gains tax.

Senator Leonard: On land.

Senator Hays: Yes, on land, but they had the privilege and the jurisdiction to put in an unearned increment tax. This would have made it possible for the provinces to raise their own money. You said you required some of these additional funds. I was wondering if any consideration had been given in the department to letting the provinces raise money the way they see fit.

Mr. Bryce: If they wish to do it that way, they can. We felt that a tax on capital gains was essential in order to make the whole income tax system effective and to make it fair, and that we could do it without severe economic penalty. That is the basic argument for it.

Senator Hays: You have admitted indirectly that you could not police the old taxation system, the way you say you could police this one in the White Paper.

Mr. Bryce: I think Mr. Brown is a much better witness on that point.

Mr. Brown: I do not think anyone ever admitted they could not police the old income tax structure. What one can say about it is that it was a relatively simple structure and it was being applied in what had become a relatively sophisticated community. A rule that is a little rough and ready but not too bad after the event no longer works very well in Canada because many people can see what the effect of the rule is and, as it was once described to me, they can respond enthusiastically to any incentives in the Tax Act. As a consequence, it was not a question of policing so much as it was that people had responded enthusiastically to every spot in the Tax Act that had a loophole. There is nothing wrong in that.

Senator Hays: But you have kept plugging holes ever since 1960 and just as you have them all about plugged you are going to open the sieve again and start replugging them.

Mr. Brown: If you have ever started to patch a roof you know that putting patches on often creates three or four leaks around the edges. For every leak you cover you start three more, so you might as well put a new roof on.

The Chairman: In your proposal here, when you are stating what you are proposing to do, you say that this creates a loophole. I thought that was something in the law. You are talking about loopholes in the proposals, and you have to put restrictions on what you call plugging loopholes.

Senator Hays: I think you are taking a pretty well patched roof and are taking it all off.

The Chairman: It has all the elements of that.

Senator Everett: Earlier, in talking about the fact you did not want the valuation to be unfair, you said there would be a valuation date and there would be no retroactivity in the valuation date. Mr. Asper, writing for the *Globe and Mail,* has raised the point that in a closely held corporation the value will be the book value, and that the goodwill existing between the book value and the actual value of the company on the valuation date will be taxed. Now, I am asking you to clarify that situation. Is Mr. Asper correct?

Senator Benidickson: He referred to that, Mr. Brown, as something in the nature of a bombshell that was not recognized by the public.

Mr. Brown: That may be, senator. I think the short answer would be no and yes, but that is not a clarification. The section of the report at the end of chapter four contains an example of what would happen in the absence of some special rules dealing with closely held corporations. The example given deals with a building on which there has been capital cost allowance. If the building were sold for its current market value there would be, under the existing system, a corporate tax and a personal tax if the proceeds were distributed.

It is pointed out in the paper that in the absence of some special rule, if the value of the shares of that corporation were set at the value of the assets, in effect there would be no tax on recapture.

Perhaps a more dramatic example might have been to talk about a company in the oil business which was at that point where it had just written off the cost of acquiring, developing, and exploring a piece of oil property, so that it had no deductions left from the stream of income from that property. Of course, under the existing act, if the property was sold the proceeds would be taxable.

Suppose for the purposes of my illustration that that property was worth $1 million. If the owner of that company could start out by saying: "My shares are worth $1 million", he would, because all tax paid by the company is creditable to the shareholder, have the full deduction on the—

Senator Benidickson: That is the situation that exists today.

Mr. Brown: I am sorry; that is not the situation that exists today.

Senator Benidickson: It is if he sells the shares, is it not?

Mr. Brown: If he sells the shares, but nevertheless the person who buys from him has to face full personal and corporate tax on the income derived from the oil property.

Perhaps we might deal with V-day valuation. If he sold his shares the day after he would have a tax free receipt of $1 million. That is the whole essence of it. But, assume for the moment that there were no special provisions, and that the day after V-Day he caused the company to sell the property, and then took all the money out of the company. The effect then would be that he would get $1 million income, and he would have a deduction for the $1 million that the shares were valued at. He would have no tax to pay on a transaction which the day before would have been taxable. This is a slow build-up to deal with the more important aspect of your question, namely, the goodwill aspect.

Senator Everett: Mr. Asper suspects that you are taxing retroactively, and that is what I am really asking about.

Mr. Brown: All I can do is explain what we are doing—

Senator Everett: I put the question to you in that context.

Mr. Brown: —and perhaps you can draw the conclusions.

Senator Everett: I hope you will too.

Mr. Brown: I find it hard not to sometimes.

The Chairman: Do you mean that you are not going to interpret what you have written?

Mr. Brown: The drawing of conclusions is different from interpreting.

Senator Everett: This is a matter of real issue. Mr. Asper has said that one of the principles enunciated a while ago was that the Government does not want to tax retroactively, and he said that in this particular situation where you are dealing with the shares of a closely held corporation there is an intention to tax retroactively disclosed in the White Paper.

Mr. Brown: Let me deal with goodwill, and you can ask me to draw what conclusions I will at the end. The proposal with respect to goodwill, is that purchased goodwill from the day after this system begins, if it begins, will

become a deductible expense. It may be amortized over time, but it will be a deduction, and it is not today. With that in mind, it was felt that the price that a purchaser would be willing to pay for goodwill would come up the day after the system begins. For this reason it is suggested in the White Paper that a sale of goodwill the day after the new system begins would be, if I recall the figure correctly, 40 per cent taxable income, and 60 per cent tax free receipt.

Here is one point at which we have to ask ourselves if that is retroactive. It is not retroactive if you agree that the price will go up—if you agree that the price will go, let us say, from 100 to 125—but you will have to come to that conclusion yourself. That will have to be done by coming to some conclusion as to what the right to deduct goodwill is worth. You will have to decide the tax saving worth of having, let us say, $125-worth of expenditures. Is it worth $25. That is a discounting function, and it is mathematics. So, the first proposal relating to goodwill is that on the sale, immediately after the start of the system, 40 per cent would be taxable.

Then, the next view on goodwill is that it is not a "once and for all" thing. The goodwill that a company has today is the product of what it has done in the past. The goodwill that a company has ten years from now is the product of what it has done in the past and of what it has done in the intervening ten years. The clearest example is ..

The Chairman: In the first year is 40 per cent taxed?

Mr. Brown: Yes.

The Chairman: And then do you add 5 per cent per year?

Mr. Brown: Yes.

The Chairman: Does that mean that whatever is left of the goodwill 45 per cent of the remainder is taxed—or is it 45 per cent of the original amount?

Mr. Brown: It is 45 per cent of the proceeds. I was about to explain why this change in percentage...

The Chairman: Let us say the goodwill has an established value of $100,000. Apply the formula to that.

Mr. Brown: First of all, if the business had been sold with the goodwill, and the goodwill brought at price of $100,000 the day after the system began, then the philosophy...

Senator Benidickson: Excuse me, when you say "the day after the system began" do you mean on this valuation day? It is on that day, to take the chairman's example, that it is worth $100,000?

Mr. Brown: Yes, so we need to ask if it is $100,000 immediately before the system...

The Chairman: No, I am talking about a situation in which this law is in force, and then the sale is made.

Mr. Brown: Then I shall have to back up a bit. The assumption on which this is based—my mathematics may not be too precise—is that that goodwill would have brought a price of $80,000 before the system went into effect, but it brought a price of $100,000 when the purchaser could deduct it from taxable income. On that basis, 40 per cent of your $100,000 would go into taxable income, with a maximum tax of 50 per cent—you can see that I am coming out all right—which would mean a tax of $20,000, and he would net his $80,000. That explains the 40 per cent.

Mr. Bryce: That is, if he sells in the first year.

Senator Everett: This applies to the vendor?

Mr. Brown: Yes.

Senator Everett: What about the purchaser?

Mr. Brown: He could write it off completely over the period.

The Chairman: Is that on a straight line basis?

Mr. Brown: No, it is on a diminishing balance.

The Chairman: What is the definition of "goodwill"? It is the difference between book value and the sale price, or the difference between market value and the sale price, is it not?

Mr. Brown: This is a wonderful world—the question of what is goodwill.

Senator Everett: Do you mean to say that you do not know?

Mr. Brown: Goodwill is really the value placed on the likelihood that a customer will

deal with this particular company rather than with a competitor who starts up across the street.

Senator Everett: I know the esoteric definition of "goodwill". What is the pragmatic definition?

Mr. Brown: The really pragmatic definition is that it is the amount set out in the sales agreement relating to the goodwill, but somewhere in between the two is the fact...

Senator Everett: Do we have a guarantee that the minister will not interfere with that?

Mr. Brown: If it is not too unreasonable I think you can take if for granted that he would not. On the other hand, if he is selling a building which everyone realizes is worth $3 million and he puts the value as $100,000 and the goodwill as $2,900,000, you can expect discussion with the tax department on the purchase price. In the pragmatic working out of a particular transaction the value of the tangible assets would be examined and the rest thrown into goodwill.

Senator Everett: Is that the book value of intangible assets?

Mr. Brown: The real, fair market value. If it were land, for example, I would assume that the vendor would want to have the true market value, since that would be capital gain. If it were a building subject to recapture, he might have the temptation to allocate it to goodwill, because only 40 per cent would be taxed and if it were put on the building 100 per cent would be taxed. There is room for difference in interest and consequently point of view.

To return to the increased incentive, senator, there is a view in the White Paper, as I see it, that goodwill only would stay at $100,000 if the company acted in such a way during that first year as to maintain that $100,000.

Senator Everett: In other words, just to make profits?

Mr. Brown: Oh, no, to render good service. You can make lots of profits for a short time perhaps and run your goodwill into the ground. It has been known to happen. You can suffer losses and increase your goodwill.

Senator Everett: You had better increase your goodwill.

Mr. Brown: You had better do something.

Senator Molson: How do you measure that, Mr. Brown?

Mr. Brown: This is what lies behind the mathematical formula, the assumption that you cannot measure it exactly. The formula suggests that over the next 12 years the increasing proportion of the goodwill of that remaining 60 per cent of the proceeds will be assumed to have come from goodwill which was the product of activities after the new system began.

Senator Molson: Forty per cent prior, 60 per cent future?

Mr. Brown: Yes. It is assumed that once 12 years has gone by the goodwill will relate entirely to the actions of the company after the system has begun.

The Chairman: Is there a position paper to indicate how you are going to measure the value?

Mr. Brown: What is necessary if these proposals are adopted is to identify in any sale the portion of the proceeds that relates to goodwill. It is not necessary to establish the value of the goodwill at D-day, nor to deal with the goodwill of a business which is not sold in 12 years.

Senator Everett: What portion of the shares on valuation day represents the goodwill on that day?

Mr. Brown: It is not necessary, however, to value individually all of the tangible assets and squeeze out the goodwill. Consequently, it will only be necessary to value the business as a whole. Valuations of businesses which go on now do not necessarily depend on an itemization of all the assets and throwing in something for goodwill. Much more often you value the business as a total and you do not break down precisely what the goodwill is.

Senator Everett: Supposing the asset of the company is land and on valuation day the land had increased in value by five times, does that constitute the goodwill?

Mr. Brown: No.

Senator Everett: If on the following day the company is sold?

Mr. Brown: The land is sold?

Senator Everett: The shares of the company are sold. The fair market value or the valuation value is the fair market value of the land on valuation day.

The Chairman: No, but have you settled that goodwill applies as part of the sale price of shares or only as part of the sale price of assets or a business? Which are we dealing with?

Mr. Brown: The example given was a sale of shares and, of course, that would depend on the D-day value. It does not matter what the assets are backing it up.

Senator Everett: Mr. Asper is suggesting that you will only accept book value.

Mr. Brown: I have read Mr. Asper's column. First of all, I do not think he suggests that. Secondly, I think it is what the White Paper suggests which should be discussed.

The Chairman: Except that ultimately his interpretation might be accepted.

Mr. Brown: His suggestion is that people with companies where they might want to sell the business might well want to value their shares low. They might find it in their economic interest to value the shares low in order that there would not be any non-creditable tax. His suggestion was not that the Government would not accept the fair market value of the shares, not at all.

The Chairman: Gentlemen, I had thought we might be going on until about 12.45 today, but it becomes necessary, because of some other meetings that must go on and be dealt with later today, that we should adjourn within the next five minutes. What we append to this period today is what is done in a serial story: to be continued. I want to leave this thought with you, Mr. Brown and Mr. Bryce: have you considered, for instance, in the sale of a principal residence the gain is taxable under the White Paper? Now in the United States, as I understand it, they allow a period to roll over the money that you receive on the sale of the property. I think you have a year in which to expend that money to acquire another principal residence. When you come here next time, will you be ready to rationalize that, because my suggestion is that the roll-over provision here should apply in relation to the principal residence. The reason I say that is because it appears that the design of this particular point is aimed at principal residences. I say that deliberately, because the courts have practically made gains on all kinds of real estate transactions ordinary income, so they are now in the income and the tax revenues of the country as income. It is very difficult except on the sale of a private residence to establish a real estate transaction in the courts today that does not attract tax on the gain as being income.

Senator Benidickson: Mr. Chairman, you would include residential farming.

The Chairman: A homestead property, too, and a principal residence, that they should roll it over. That is, if they spend it in a replacement. I do not know what the charm or the judgment decision was on the ten miles, that you can roll over a sale of a principal residence and acquire another one within ten miles closer to the place where you work. I wonder if you could rationalize that and express a view on what I have suggested to you, first of all that the area of tax on real estate is practically exhausted by the court decisions and it is income. Therefore it is already in your income revenues and I would assume does not enter into any part of the calculation of taxes on capital gains.

Mr. Bryce: Additional taxation.

The Chairman: Additional taxation. The second question on which I would like to have an answer is whether you took the 1967 data and made your computations on that for purposes of this paper applied to the year 1969. In 1969 we established a new tax base and provided you by that legislation with what you estimated to be about $100 million of additional tax revenue from taxing life insurance companies. I want to know whether that has been reflected, or whether this is the sum total of more tax that we have coming into the tax revenues, and therefore a greater increase in tax revenues than has been disclosed either in the White Paper or in the calculations Mr. Gilmore made.

Mr. Bryce: The revenue from taxation of life insurance companies is in the revenue of the present system and we do not include that in these figures on what the proposals would produce.

The Chairman: In your calculations you used up that $100 million, which was the estimate?

Mr. Bryce: It is part of the present law and we have...

The Chairman: It only came into force during the year 1969.

Mr. Bryce: Yes.

Senator Phillips (Rigaud): You see, you used the 1967 year and computerizzd it on a deemed-to-be-income in 1969, but the insurance taxation was not in force in 1967. I think that is the Chairman's point.

Mr. Bryce: We have tried to set out the effects of these proposals.

The Chairman: Would you see to it that we get the position papers to which the minister referred in the Commons committee? A number of them were referred to. In one place he spoke about a position paper, in other cases he spoke about problems that they were presented with. I would assume that when he mentioned problems he intended to give some kind of position paper in relation to them, and we want all the information you have got. You have made a judgment decision, and it is common knowledge that judgments are worth only the validity of the reasons supporting them.

Senator Leonard: I think he was also taking into consideration taxation of public utilities or corporate taxes of the provinces.

The Chairman: There is a principle involved there. Somebody will have to deal with it. Parliament, of course, did deal with it to the extent of 95 per cent.

Senator Leonard: That is right, but Mr. Bryce and Mr. Brown are also probably familiar with the fact that the minister has made some statement in connection with it.

The Chairman: The committee will now adjourn. We will meet in the ordinary way next Wednesday morning. If there are other meetings during the week you will be advised in good time. You will be furnished with the Noranda brief and our working papers on it during the afternoon.

Senator Macnaughton: Is the Noranda meeting tomorrow?

The Chairman: Tomorrow morning.

Senator Macnaughton: At nine o'clock?

The Chairman: Tomorrow morning at nine o'clock.

Mr. Bryce: Will you want us here next Wednesday morning ?

The Chairman: Yes, unless we say differently. If you wish to have somebody here while we are dealing with Noranda, that will be perfectly all right.

Mr. Bryce: We will have somebody here.

The committee adjourned.

APPENDIX "A"

—PROPOSALS FOR TAX REFORM— EFFECT ON TAX REVENUES

Proposals affecting Invididuals that will reduce taxation revenues	Reduction in Taxes: First Year ($ million)	Reduction in Taxes: Five Years hence
Increase in personal exemptions.....	1,000	1,000

8.14 Given the present rate structure as described above and present deductions and allowances, the increase in the exemption for single persons, and others taxed as single, to $1,400 from $1,000 and in the exemption for those taxed as married persons to $2,800 from $2,000 is estimated to cost $1 billion on 1969 incomes.

Additional deductions from income because of recognition of	First Year	Five Years hence
(1) Employment expenses........	235	235
(2) Baby sitters expenses........	95	95
(3) Employee contributions to unemployment insurance.....	65	65

8.16 With the new personal exemptions and rate structure in effect it is calculated that the cost of the proposed employment expenses allowance of 3 per cent of income up to a maximum of $150 would be $235 million. This can be calculated accurately by the computer for 1967, and has been projected to 1969. On the other hand, it is much more difficult to estimate the cost of the next item, the child care allowance (see paragraph 2.7). There is very little information on the expenses to be made eligible. Nor is it known to what extent mothers not now working would get jobs and take advantage of the proposal. It has been projected at an estimated cost of $95 million. The cost could turn out to be one-third more or less than this.

8.17 Taxing unemployment insurance benefits in 1969 would have increased tax revenues by about $85 million. Allowing the deduction of employee contributions would have reduced tax revenues by about $65 million. These estimates have been made on the basis of the current scales of benefits and contributions. A change in benefit and contribution levels could have a significant effect on these amounts.

	First Year	Five Years hence
Reduction in top rate of tax on individuals to 50%.................	0	40

Proposals affecting Individuals that will increase taxation revenues	Increases in Taxes: First Year ($ million)	Increases in Taxes: Five Years hence
Increases in taxes caused by introduction of new Schedule of tax rates applicable to individuals............	1,255	1,255

8.15 Given these increased exemptions but no other changes in the tax law, the change in the tax rates from the present complex of rates (including basic tax, old age security, social development, etc.) to the new simplified rate schedules proposed in Chapter 2 and set forth in Table 2, would increase aggregate revenues by $1,255 million on 1969 incomes. The effects of the subsequent reduction in top rates is noted below, in paragraph *8.19*.

	First Year	Five Years hence
Taxation of unemployment insurance benefits.......................	85	85

8.17 Taxing unemployment insurance benefits in 1969 would have increased tax revenues by about $85 million. Allowing the deduction of employee contributions would have reduced tax revenues by about $65 million. These estimates have been made on the basis of the current scales of benefits and contributions. A change in benefit and contribution levels could have a significant effect on these amounts.

		First Year	Five Years hence
Sundry additions to income and reductions in deductible expenses comprising..............................		100	100
(1) Adult occupational training allowances.............	[illegible]		
(2) Increase in taxation of Canadian Armed Forces..	10		
(3) Personal use of business cars.........................	[illegible]		
(4) Increased taxation of co-operatives, credit unions and caisse populaires......	5		

Proposals affecting Individuals that will reduce taxation revenues	Reduction in Taxes First Year ($ million)	Five Years hence

8.19 The reduction in the top rates of tax does not apply in the first year. It is estimated that by the fifth year when the transition would be complete, it would cost $40 million on the basis of 1969 incomes. This amount does not include what those extra rates would have produced on capital gains in the fifth year, because it is felt that the very high top rates would be imcompatible with the tax treatment proposed for capital gains.

Averaging of Income	0	50
	1,395	1,485

8.21 The new averaging formula would not be in effect in the first year of the new system, and so would not affect revenue that year. By the fifth year it would be fully effective, at an estimated cost of $50 million.

Increase in dividend credits allowed to individuals	140	230

8.22 The final item to be taken into account is the proposed change from the dividend tax credits to a new system for giving shareholders credit for part or all of the Canadian taxes paid by their corporations. Our expectations concerning the dividend policies of corporations were noted in paragraph *8.10*. On the basis of those expectations it is estimated that this change would have cost $140 million in personal tax revenue in 1969 if that had been the first year of the system and $230 million if it had been the fifth year of the system. The cost of this change must of course be considered together with the increased revenue expected from the removal of the low rate of corporation tax and from the taxation of dividends from widely-held Canadian corporations when received by closely-held corporations. Together these two corporate changes would have produced $155 million in tax revenue in 1969 if that had been the first year of the proposed system and $450 million if it had been the fifth.

8.23 The $140 million is the net of three amounts. First, the estimated credit to be given to shareholders would reduce revenues. Offsetting this there would be additional revenue from the tax collected on that credit, and on the increased dividends it is expected that the proposed system would prompt. Finally the present 20-per-cent divi-

Proposals affecting Individuals that will increase taxation revenues		Increases in Taxes First Year ($ million)	Five Years hence
(5) Fellowships and grants	5		
(6) Restriction of capital cost allowances on buildings	27		
(7) Cancellation of depleting allowances to non-operators of oil and gas wells	15		
(8) Cancellation of deductions for entertainment expenses	12		
(9) Reduction in allowable medical expenses	6		
	100		
		1,440	1,440

8.18 A number of other smaller additions to revenue would arise from the inclusion of additional items in income and the reduction or elimination of some deductions. The total revenue forecast from the first group is $40 million and from the second group $60 million. The details of these changes and of the estimated revenue effects are set out in the footnotes to Table 15.

Taxes payable on capital gains of individuals, comprising		
(1) Taxes on realized gains	60	245
(2) Taxes on unrealized gains resulting from five year revaluation	0	100

8.20 In the first year of the revised system, the inclusion of realized capital gains in income and the deduction of capital losses are estimated to produce net revenue of $60 million. This does not reflect an estimate of actual market behavior in 1969 but rather the longer-term relationship established in earlier years. It must be emphasized that this item cannot be forecast accurately, because it depends on changes in market values after the valuation date to be designated and on the behavior of Canadians confronted with a wholly new tax situation. If 1969 were the fifth year of the proposed system, the net tax revenue from realized gains and losses is estimated at $245 million. In addition, there is an amount of $100 million in respect of net gains arising through the periodic revaluation of the shares of widely-held Canadian corporations. In the fifth year, approximately one-fifth of the taxpayers who hold shares would follow this process.

Proposals affecting Individuals that will reduce taxation revenues	Reduction in Taxes: First Year ($ million)	Five Years hence
dend tax credit would be cancelled: this would reduce the net cost of the proposed system. The following schedule illustrates the interaction of these three factors: the provincial figures are based upon a provincial tax at 28 per cent of federal tax.		
	1,535	1,715
Net loss of tax revenues in first year	35	
Net increase in tax revenues five years hence		70

Proposals affecting Corporations that will reduce taxation revenues	Reduction in Taxes: First Year	Five Years hence
	($million)	
Reduction in taxes resulting from giving capital cost allowances on Goodwill and other intangible capital costs	5	5
Reduction in taxes from allowing companies whose principal business is not in the mineral or oil and gas business to amortize expenditures against income	5	10

8.28 Some modest loss of corporate tax revenue would arise from two sets of changes in taxing business income. The granting of capital cost allowances for "capital nothings", including goodwill, is estimated to cost about $5 million in each year. The broadening of the incentive offered for mineral exploration and development by permitting the write-off of such expenditures against other income by companies whose principal business is not mineral production or certain allied activities is estimated to cost $5 million in revenue in the first year, and $10 million in the fifth.

Proposals affecting Individuals that will increase taxation revenues	Increases in Taxes: First Year ($ million)	Five Years hence
	1,500	1,785

Proposals affecting Corporations that will increase taxation revenues	Increase in Taxes: First Year	Five Years hence
	($million)	
Elimination of lower rate of tax on first $35,000 of taxable income of corporations	95	390

8.25 The main change, of course, is the gradual reduction over five years of the amount of corporate income subject to the 21-per-cent rate of tax. This would increase the yield of the federal corporation income tax by an estimated $95 million in 1969 if that were the first year of the new system and $390 million if it were the fifth year.

Increased tax levied on dividends paid by widely-held corporations to closely-held corporations	60	60

8.26 The proposed system contemplates that a tax will be paid when a dividend is received by a closely-held Canadian corporation from a widely-held corporation (paragraph) *4.56*). This would, once the transition to the new system is complete, virtually eliminate the postponement of personal tax on this type of income. It is estimated that the extra corporation tax collected as a result of this provision would be of the order of $60 million annually, commencing in the first year.

Proposals affecting Corporations that will reduce taxation revenues	Reduction in Taxes First Year	Five Years Hence
	($million)	
	10	15
Net increase in tax revenues in first year	205	
Net increase in tax revenues five years hence		560

Proposals affecting Corporations that will increase taxation revenues	Increase in Taxes First Year	Five Years hence
	($million)	
Taxation of capital gains of corporations	35	100
Sundry increases in taxes, comprising (1) Termination of depletion allowances on royalty income . . . 10 (2) Total disallowance of entertainment expenses . . . 5 (3) Prevention of diversion of income to tax havens . . . 10	25	25
8.29 On the other hand the termination of depletion allowances on royalty income is estimated to increase revenue by $10 million in each year. The disallowance of reductions for the cost of club dues, conventions, entertainment, etc. is expected to save $5 million in revenue in both years. Finally, the new provisions to prevent diversion of income to tax-haven countries is expected to save about $10 million in both years.		
Increased tax collections resulting from payment of 15% tax on accumulated undistributed income	Not estimated	
8.30 We expect that some corporations would take advantage of the extension of the present provision permitting tax-free distribution of accumulated surpluses on payment of a 15-per-cent tax (paragraph *4.78*). However, the amounts are almost impossible to predict and could vary substantially from year to year depending upon how many and which corporations are wound up or reorganized that year, or choose to make a partial distribution of this type.		
	215	575

Proposals affecting Non-Resident withholding taxes that will reduce taxation revenues	Reduction in Taxes First Year	Five Years hence
	($million)	
Loss of tax through flow-through arrangements for foreign withholding taxes	15	15
	15	15
Net loss in tax revenues in first year	10	
Net effect five years hence		nil

8.31 The estimated revenue effects of changes in the withholding taxes are set out in Table 17 on page 96. We might expect in the first year to gain about $5 million from the withholding tax on pensions and payments to non-residents from Canadian pension funds and registered retirement savings plans. In the fifth year after the revision of the tax treaties we would expect this figure to be substantially higher, perhaps of the order of $10 million. We would also expect in the fifth year an increase in revenue from higher withholding taxes from payments made to those countries with whom we do not have tax treaties. This is estimated at roughly $5 million. On the other hand, we must expect to lose about $15 million a year on the flow-through arrangement in respect of credit for foreign withholding tax.

Proposals affecting Non-Resident withholding taxes that will increase revenues		Increase in Taxes First Year	Five Years hence
		($million)	
Increased withholding taxes on payments to non-residents, comprising			
(1) Pensions, Canada Pension fund, and registered savings funds	5		
(2) Increased withholding taxes applicable to countries with whom we have no tax treaties	0	[illegible]	15
		[illegible]	15

8.31 The estimated revenue effects of changes in the withholding taxes are set out in Table 17 on page 96. We might expect in the first year to gain about $5 million from the withholding tax on pensions and payments to non-residents from Canadian pension funds and registered retirement savings plans. In the fifth year after the revision of the tax treaties we would expect this figure to be substantially higher, perhaps of the order of $10 million. We would also expect in the first year an increase in revenue from higher withholding taxes from payments made to those countries with whom we do not have tax treaties. This is estimated at roughly $5 million. On the other hand, we must expect to lose about $15 million a year on the flow-through arrangement in respect of credit for foreign withholding tax.

SUMMARY	First Year	Five Years hence
(A) Individuals		
Increase in tax revenues	1,500	1,785
Reduction in tax revenues	1,535	1,715
Net reduction	35	
Net increase		70
(B) Corporations		
Increase in tax revenues	215	575
Reduction in tax revenues	10	15
Net increase	205	560
(C) Non-resident withholding taxes		
Increase in tax revenues	5	15
Reduction in tax revenues	15	15
Net reduction	10	nil
(D) Total		
Net increases	[illegible]	[illegible]

Second Session—Twenty-eighth Parliament

1969-70

THE SENATE OF CANADA

PROCEEDINGS

OF THE

STANDING SENATE COMMITTEE

ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 6

THURSDAY, JANUARY 29th, 1970

Second Proceedings on the Government White Paper,

entitled:

"PROPOSALS FOR TAX REFORM".

WITNESSES:

Noranda Mines Limited: Alfred Powis, President and Chief Executive Officer and Adam H. Zimmerman, Vice President and Comptroller.

APPENDICES:

"A"—Brief presented by Noranda Mines Limited.

"B"—Summary of legislation respecting Appendix "A".

21286—1

THE STANDING SENATE COMMITTEE ON
BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aseltine
Beaubien
Benidickson
Blois
Burchill
Carter
Choquette
Connolly (*Ottawa West*)
Cook
Croll
Desruisseaux
Everett
Gélinas
Giguère
Haig
Hayden
Hays
Hollett
Isnor
Kinley
Lang
Leonard
Macnaughton
Molson
Phillips (*Rigaud*)
Walker
Welch
White
Willis—(29)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate November 19, 1969:

"With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intituled: "Proposals for Tax Reform", prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

"With leave of the Senate,

The Honourable Senator Phillips (*Rigaud*) moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative."

ROBERT FORTIER,
Clerk of the Senate.

21286—1½

MINUTES OF PROCEEDINGS

THURSDAY, January 29, 1970.

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to give further consideration to:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Hayden (*Chairman*), Beaubien, Blois, Burchill, Carter, Connolly (*Ottawa West*), Cook, Everett, Gelinas, Giguere, Haig, Hays, Isnor, Kinley, Lang, Leonard, Macnaughton, Molson and Phillips (*Rigaud*). (19)

In attendance: Arthur W. Gilmour, Senior Advisor; Alan J. Irving, Legal Advisor and R. Bretton, Executive-Secretary.

The following witnesses were heard:

Noranda Mines Limited:

Alfred Powis, President and Chief Executive Officer.

Adam H. Zimmerman, Vice President and Comptroller.

Ordered:—That the brief presented by Noranda Mines Limited be printed as Appendix "A" to these proceedings.

Ordered:—That summary of the legislation and the brief as prepared by Mr. Gilmour be printed as Appendix "B" to these proceedings.

At 12:00 Noon the Committee adjourned to the call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Ottawa, Thursday, January 29, 1970

The Standing Senate Committee on Banking, Trade and Commerce, met this day at 9 a.m. to give further consideration to the White Paper entitled, "Proposals for Tax Reform".

Senator Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: Gentlemen, I call the meeting to order. We have before us this morning the representatives of Noranda Mines Limited, and appearing on behalf of the company is Mr. Alfred Powis, the President and Chief Executive Officer, Mr. Adam H. Zimmerman, the Vice President and Comptroller, Mr. D. A. Foster, Assistant Comptroller, and Mr. G. H. Corlett, also Assistant Comptroller.

At this point I should mention that you have before you what Mr. Gilmour calls a docket, and I think he should take a couple of minutes in order to explain how it works.

Mr. Arthur Gilmour, Special Tax Adviser: Gentlemen, you have had delivered to you this blue folder which has inserted inside it a buff folder. There is no significance in the colours. These just happen to be Clarkson Gordon files that I appropriated.

You also have a brief with a lot of index tabs on it. The index tabs are of various colours because we ran out of tabs of one colour while preparing the document.

The object of this buff coloured folder, which I trust will be given to you before every brief is presented from now on, contains on the front sheet a summary of what the authors of the White Paper felt would be the impact upon the mining industry. Then taking page 5 as an example of the following pages, you will see that I have divided this into several columns. The one to the left gives you a synopsis, under the heading "Exploration, Prospecting, and Development Expense", of what the present law is, showing the reference to our present Income Tax Act, and there is a very curt remark here that it is deductible from income. In the next column there is reproduced the paragraph of the White Paper that deals with this subject. Then there is reproduced a summary of what the gentlemen from Noranda think about this. I refer you here to page 4 of Noranda's brief, and the purpose of these numbered tabs is cross reference. In the brief you will notice that on page 4 there is a tab marked 5, which is your cross reference to the docket, and then the docket cross references to these pages.

I trust that this will work conveniently for you, but it may not. In due course I would be most happy to receive your criticisms, so that we may improve this system.

The Chairman: If there are any suggestions for additions in the preparation of this relating document that senators would like we can easily adapt this formula, so do not hesitate to make your suggestions.

Mr. Powis will now read parts of the brief, which is not very lengthy. The bulk of it stems from the attachments or exhibits. Mr. Zimmerman will also take a part of it and then they will be ready for questions.

Mr. Powis, you can present your brief in whatever way you feel is more comfortable. If you feel more comfortable sitting down, do it that way.

Mr. Alfred Powis, President and Chief Executive Officer, Noranda Mines Limited: Thank you, sir. I would like to start by saying we consider it a great honour to be, I believe, the first company to submit a brief before this group. I regret that we did not have time, in the circumstances, to have it translated into French, but we will have that done in due course.

This brief on behalf of Noranda Mines Limited has been prepared in a shorter time than the Company would have preferred. In the period since November 7, it has simply

not been possible for anyone to gain a complete understanding of the implications of such a drastically new system, produced after years of research. Accordingly any general conclusions at this point must be tentative in nature. While we have grave concern about the overall impact of the proposed new system, this brief will focus on the particular problems we believe it would create for Noranda and the mining industry in general.

If, during the discussion of this brief or our continuing research, further problems come to our attention, we respectfully request the opportunity to submit a supplement.

Noranda's concern with the proposals falls into three general areas:

(1) Recognition has been given to the special risks inherent in mining and the need for special tax treatment. Nevertheless, it is proposed that the present incentives be removed and replaced by provisions which would substantially increase the tax burden for the industry. Mature Canadian mines without earned depletion would pay higher taxes on income than any other segment of the economy, and considerably higher taxes than in such countries as the United States and Australia. From the standpoint of Canadian shareholders of a mining company, such incentives as are proposed are a complete illusion. The reduction in potential returns on capital employed by both the companies and their shareholders would reduce the value of mineral discoveries and thus the level of exploration which is vital to the future of the industry in Canada. Particularly for foreign companies, the real incentive would be to divert exploration out of Canada.

(2) It is proposed that the income relationships between a widely held Canadian company such as Noranda and its subsidiaries and associates, domestic and foreign, be completely altered. For a company such as Noranda, this would require a radical change in our corporate structure and the way in which we do business. These proposed changes more than any others seem to be motivated by a desire for symmetry rather than by revenue or equity considerations, and there seems to be no justification for forcing such a profound alteration in the structure of the mining industry (and many others).

(3) The entire thrust of the proposals favours consumption, rather than saving, by individuals and the payment of dividends, rather than reinvestment of earnings, by corporations. There is no way it can be proven but we are concerned that those who drafted the proposals have seriously underestimated the psychological impact the new system would have on the desire of Canadians to accumulate capital. While the proposals appear to contain a bias in favour of ownership of Canadian industry by Canadians, the opposite would happen if our concern proves correct, to say nothing of the impact on future growth and living standards.

By way of background, attached are two appendices: Noranda's presentation to the Minister of Finance following the Carter Commission report and a paper entitled "Mining Tax Incentives". The latter, prepared by J. D. Gibson with some professional mining assistance, outlines the record of the industry in the Canadian economy noting especially:

(1) A tenfold increase in the value of mineral production since the end of the war to $4\frac{1}{2}$ billion per annum.

(2) The largest single contribution to better regional economic balance in Canada.

(3) An increase in productivity notably higher than in the rest of the economy.

(4) A massive increase in exports.

In its own submission Noranda made reference to the fact that it had spent its tax benefits on exploration, the return to shareholders had been reasonable but not excessive, its resources had been devoted to Canadian development, and in the five year period 1962-1966 its effective mining and income tax rate had been 48.8%. The Committee's attention is directed particularly to sections III and V of Appendix II which deal with the nature of the special problems in the mining industry and one company's record in dealing with these.

It is understood that the Government's objective is a tax system which will:

(a) Create a comprehensive tax base.

(b) Shift the burden of taxes away from lower income groups, by increasing the tax on those better able to pay.

(c) Not impede growth and prosperity in the Canadian economy.

Noranda is in general agreement with these objectives, but believes they are incompatible with many of the Proposals. Noranda's knowledge and expertise is primarily in mining and related fields. While we believe that goals (a) and (b) could just as well be achieved by amendments to the present system, we intend to leave this discussion to others and concentrate on those Proposals where we have direct knowledge.

Accordingly, this brief deals with four major points:

(1) The distinction between the oil and mining industries.

(2) The impact of the Proposals on a typical mature and integrated Canadian mining company.

(3) The effect of the Proposals on exploration of new mines in Canada.

(4) The effect of the Proposals on the corporate structure and business practices of Noranda.

At this point, with your permission, I would like to turn it over to Mr. Zimmerman to continue.

Mr. Adam H. Zimmerman, Vice President and Comptroller, Noranda Mines Limited: Honourable senators, the distinction between the oil and mining industries is the mining industry's great misfortune to have been grouped with the oil and gas industry in the proposals under the category of "Operators of Mineral Resources". In fact, the two industries are completely different and there would be as much logic in grouping automobiles with beer because they are both sold to consumers.

Apparently equal treatment is proposed for the two industries, but the overall impact on the mining industry would be very considerably more severe than in the case of oil and gas for two reasons:

(1) It is proposed that the mining industry lose the three year period of tax exemption, which never applied to oil and gas.

(2) It is proposed that each industry earn depletion in the same manner, although the structure of the two industries is such that the depletion could be earned very much more easily by the oil and gas producers than by mines.

The basis of the depletion allowances proposed is that they be earned by investment in new plant, exploration and development, for which $3 must be spent for each $1 of depletion credit allowed. New plant for this purpose would apparently not include extension or replacement of existing operations. This compares with present regulations which depletion is simply one-third of taxable mineral income.

Honourable senators, if you look at the end, after the first blue divider, there are two charts which are intended to describe the differences graphically. The first is the difference between the oil and petroleum industries and the mining industry, and the other the effect of the new regulations. I should add that in Exhibit A there were not enough figures available in 1967 to show the land costs claimed.

It will be seen from the attached Exhibit A that, although the expenditures of both industries are approximately the same, the oil industry spends three to five times as much on exploration and development. Because the proposals do not include capital expenditures on existing plant in the depletion base, the capital expenditures shown for mining companies (which include substantial plant additions or replacement and mine development) would be much reduced for depletion base purposes. Accordingly, allowable depletion for mines would be small indeed.

Exhibit B shows present depletion compared with taxes payable for both industries as well as what is proposed. The result is fairly obvious—that any increase in tax revenues from the existing mineral industries would come entirely from the mining companies.

If the principle of earned depletion is accepted, then it is completely illogical to exclude capital expenditures incurred after a new mine has reached production. These are very often expenditures which would have been made at the outset had all the facts

about the orebody, markets, technology or changing government regulations been known. In other cases, these are expenditures which would have been made as part of the original project but are deferred in order to keep down the initial capital requirement.

In any case, the relatively unimportant depletion incentive which would remain under the Proposals is an illusion, as explained later, since essentially it would be taxed away in the hands of the shareholder.

The Effect of the Proposals on Gaspé Copper Mines

This company was chosen, honourable senators, because it is a mature mine and includes treatment facilities up to the production of prime metals and has a smelter. Gaspé Copper Mines Ltd. is chosen as an example of the impact of the Proposals on a typical mature mining company as it is similar in nature to the type of copper mining operation commonly being developed—large tonnage, low grade orebodies being mined by open pit methods. Examples are the Tyrone mine in the U.S., the Peko mine in Australia or the Northgate mine in Ireland. Perhaps the best example would be Mount Lyell in Australia.

Located in the heart of the Gaspé Peninsula where it is the major industry, the mine was first discovered in the 1930's but only brought into production in 1956 at a cost of $48 million. Since coming into production, $21 million have been spent on expansion of the original plant and mine workings and a further $15 million was recently spent to develop a secondary orebody. The smelter treats production from Gaspé's two mines as well as others in Quebec, Newfoundland and New Brunswick.

When it came into production, Gaspé was the lowest grade copper mine operating in Canada, and it endured a number of difficulties and misfortunes. These included difficulty in achieving full production due to untrained local labour, a decline in copper prices of more than 50%, power shortages and a seven month strike.

Today, all these difficulties have been overcome and Gaspé Copper is one of the most efficient and profitable operations in the Noranda group. From a national viewpoint, the operation has also made a significant contribution:

(1) It has provided stable employment for 1,200 people directly, and many more indirectly, in one of Canada's most economically depressed areas.

(2) It has created a new and modern town in the Gaspé Peninsula.

(3) It has established a smelter which treats material which otherwise would have been exported in raw form.

(4) It has developed methods for the economic extraction of further difficult and low grade ore, previously considered waste.

(5) It has become a substantial contributor to the Provincial and Federal Treasuries.

It seems not to be generally recognized that mining companies are subject to provincial mining taxes as well as federal and provincial income taxes. These taxes are sometimes considered a royalty but they are generally payable irrespective of whether the Crown owns the mineral rights. The federal government has argued that, since they are levied by the provinces, they are none of its concern. However, these mining taxes are taxes on income, they produce revenue to the provinces which the federal government would otherwise have to provide, and are an important factor in appraising the economics of a new mine. When these are taken into account, present overall taxes on mining operations in Canada are comparable to those paid in such countries as the United States and Australia and, in fact, are higher for mature mining operations.

Although Gaspé Copper paid mining taxes from the beginning, no federal income tax was paid for the first seven years of operation, nor would there have been any paid for that period under the new Proposals. While this may seem generous, it is a situation common to other resource enterprises such as pulp and paper where capital costs are very large, or to projects taking advantage of area development programmes.

Taxes paid by Gaspé Copper to date are compared below with the taxes it would have paid had the new Proposals been in effect, and the taxes it would have paid in the U.S., Australia and Ireland:

1956 through 1968	Actual	New Proposals	U.S.	Australia	Ireland
Profits before taxes (millions)	$ 95.9	$ 95.9	$ 95.9	$ 95.9	$ 95.9
Taxes on income	28.4	40.3	24.8	28.9	—
Net profit	$ 67.5	$ 55.6	$ 71.1	$ 67.0	$ 95.9
Effective tax rate	29%	42%	26%	30%	—
1968 only					
Profits before taxes	$ 17.2	$ 17.2	$ 17.2	$ 17.2	$ 17.2
Taxes on income	7.4	9.5	5.6	6.2	—
Net profit	$ 9.8	$ 7.7	$ 11.6	$ 11.0	$ 17.2
Effective tax rate	43%	55%	32%	36%	—

I should say these are our best calculations. There are minor differences between states in the United States and Australia. There are also in some cases, rules applying to different metals. The results of all this are shown in the years to date. For taxes paid on actual income it would have been 29 per cent; for new proposals, 42 per cent; the U.S., 26 per cent; Australia, 30 per cent; and Ireland, nothing. In 1968, when it was fully matured, it was 43 per cent, actual; 55 per cent, new proposals; 32 per cent, the U.S.; 36 per cent, Australia; and, again, nothing in Ireland.

Under present tax laws, Gaspé Copper to date would have been approximately as profitable in two of the three countries, but the more mature the mine the heavier the relative Canadian tax load becomes. Adoption of the new Proposals would substantially increase the tax burden, and we are convinced that this would have a profound impact on the incentive to explore for new mines, and thus on the industry's future.

Effect on Exploration

Exploration for new mines is unlike any other form of business activity, in that the odds against success are astronomical. It has been estimated that only one property out of 10,000 staked in Canada ever results in a mine, and few of these are of any substantial size. In Canada, most of the easily accessible outcropping deposits have been found, and discoveries require increasingly sophisticated and expensive exploration methods. In terms of the average cost of finding a new orebody, it is estimated that some $30 million are spent on exploration for each new discovery as opposed to $12 million in Australia, which has not yet been nearly so extensively explored. This by no means is to suggest that we have even begun to scratch the surface in terms of Canada's mineral wealth, but merely to point out the process is becoming very expensive. It is obvious that our mineral potential will not be realized unless exploration expenditures continue to increase.

The mere conducting of an exploration programme is no guarantee of success, as luck plays an essential part. With an annual budget now of $5 million per year in Canada, Noranda has not made discovery of consequence in the past 10 years. On the other hand an associate, Mattagami Lake Mines, has apparently made a major discovery near Sturgeon Lake in its second year of a programme involving expenditure of $500,000 per year.

At the same time, exploration is vital to the survival, let alone the growth, of the Canadian mining industry. Canadian ore reserves in relation to production are low in comparison with those of other nations. In fact there is evidence that we are drawing on this country's ore reserves faster than they are being replaced, and increasing exploration activity is essential if the industry is to maintain its contribution to the national economy.

Under the present system there are probably more mines which were begun in high hopes and failed than mines which expanded and prospered. Any new mine augments the nation's mineral reserves, and provides business for secondary industry, wages for a work force, and mining and sales taxes. Surely this is desirable in itself, albeit not so desirable as an operation which will endure and pay income taxes. It is a certainty that these marginal chances would be eliminated under the Proposals and whatever benefit they are to the economy would be lost.

It is not possible to prove that the new tax proposals would reduce substantially the level

of Canadian exploration, as the real effect is a matter of opinion and would only become apparent over a period of time. Nevertheless, we are convinced that the effect would be substantial. A study conducted by the Institute of Quantitative Analysis of the University of Toronto for the Department of Finance concluded that implementation of the Carter Commission proposals would reduce the value of an average mineral discovery by 40 per cent and that the drop in the level of exploration would be of the same order. We believe this to be a minimal estimate and the drop could be much more severe under either Carter or the proposed system.

The level of exploration in Canada would decline because the value of a new deposit would be lower and because companies operating in this country would have less capital available to conduct exploration and develop new discoveries. Activity would certainly not cease entirely in the case of Canadian companies without foreign operations, since they are to some extent locked in by the non-deductibility of expenditures outside Canada and the onerous provisions regarding foreign-source income. Foreign companies, however, would almost certainly find Canada a considerably less desirable area for exploration.

In Noranda's own case, we have been uncertain as to the future tax structure for over 5 years and have felt it necessary to build up our staffs and capabilities in other countries. Whereas 80 per cent of our expenditures 5 years ago were in Canada, our budget for 1970 calls for 50 per cent of our exploration expenditures outside Canada. If the new Proposals are implemented, the proper course for Noranda to follow would be to acquire substantial foreign income against which our expanding efforts outside Canada could be written off for tax purposes.

The effect of tax uncertainties has already slowed down the growth of the industry, as indicated by the fact that mining is the only major industrial sector with declining investment expectations in 1970, for the second year in a row. Given the long lead time between discovery and first production of a new mine, however, a slowdown in exploration now would only really become felt in the latter half of the 1970's. The ultimate effect, nevertheless, would be drastic and adverse for Canada.

Mr. Powis: At this point, Mr. Chairman, I would like to deal with the corporate considerations raised by the proposals contained in the White Paper.

Corporate Considerations

The implications of the Proposals in terms of Noranda's corporate structure and methods of doing business are so far-reaching and complex that, despite considerable study, we do not feel we yet completely understand them. We also believe that those who drafted the Proposals could not have intended the results which we think will flow from them.

For a corporation such as Noranda, the problems stem from three sources:

(1) The proposed treatment of dividends from other Canadian and foreign companies.

(2) The proposed method of calculating taxes payable on dividends received by Noranda shareholders.

(3) The principle of earned depletion.

In order to clarify the problem, some background as to the structure of the Noranda group is essential. Exhibit C shows the corporate structure of the Noranda group, with the operating companies divided between those owned 50 per cent or more and normally consolidated, and those owned 25 per cent to 50 per cent. Also shown is the division between closely held and widely held corporations, and between domestic and foreign operations.

Behind the two charts to which Mr. Zimmerman previously referred is a fold-out of some dimensions which shows the corporate structure of Noranda. On the left-hand side are shown the Canadian domestic operations of Noranda. The companies in the red part of the chart are subsidiary companies which are normally consolidated. In the green part are companies of which we own less than 50 per cent and are not consolidated. In blue are shown the widely-held corporations. The ones in black are closely-held corporations. On the right-hand side the thing is repeated for foreign operations or foreign interests.

While at first glance this may appear to be a kind of jungle, it is the natural result of the way our business is carried out and in practice is eminently workable and efficient.

An interest in, or ownership of, a mining operation is acquired in three principal ways—

(a) Discovery.

(b) Financing the development of orebodies found by others.

(c) Open market purchases of established companies.

In many cases the discoverer is incapable of providing the necessary finances or technical talent necessary to develop a mine. The normal practice is then to deal with a company with the necessary resources, and the property is put in a new company in which the discover retains a share interest while the developer gets an interest for its role (e.g. Gaspé Copper or Mattagami Lake). Thus each operating mine property tends to be in a separate company. Open market purchases usually leave a substantial outside interest (e.g. Placer or Kerr Addison). Other times, joint ventures are desirable from the outset for reasons of marketing or technical ability (e.g. Central Canada Potash). In still other cases full ownership is achieved either by merger (e.g. Geco Division) or discovery (e.g. Brynnor), with the result that the operation may be carried on in either a division of the company or a closely held subsidiary. There are also instances where a direct interest is held in one company (e.g. Mattagami Lake) and a further interest is acquired indirectly through another company (e.g. Placer).

This method of doing business has worked well and has been entirely feasible under existing tax laws. Under the new Proposals it would be impossible for the following reasons:

(1) Depletion would be earned by individual companies and cannot normally be transferred among companies. Thus, one company in the group might have 10 years of earned depletion allowance available while several others were paying taxes at close to 60 per ent.

(2) Depletion earned by a subsidiary would largely be taken away in the hands of Noranda when earnings were paid out as dividends, by virtue of the treatment of inter-company dividends.

(3) Depletion earned by Noranda would largely be taken away in the hands of its shareholders by virtue of the method of calculating creditable tax. Indeed a low tax rate in any subsidiary or associated company for whatever reason may be of no value to the ultimate shareholder as a result of the 'topping up' process.

To illustrate, the table below shows the impact of the proposals on a mining company (with and without earned depletion) and an industrial company.

Tax Calculation	Mining Company With depletion	Mining Company Without depletion	Industrial Company
Income before taxes	$200	$200	$200
Mining tax—15%	30	30	—
Income Tax	57	85	100
Available for distribution	113	85	100

Tax Calculation	Mining Company With depletion	Mining Company Without depletion	Industrial Company
Payment from Subsidiary			
Available for distribution	$113	$ 85	$100
Retained by parent	95	85	100
Payment by Parent			
Available for distribution	$113	$ 85	$100
Retained by shareholder**	71	64	75

** Assumed to be in 50% marginal tax bracket. In the case of a mining company with depletion, this amount would be the same whether the parent or a subsidiary had earned the depletion.

In this table I have tried to follow the tables in the White Paper on pages 51 and 56. In each case we have taken a mining company with income before taxes of $200 and an industrial company in the same position, the mining company being with and without depletion. If the mining company has earned depletion it would have available for distribution to its shareholders $113, and in the absence of earned depletion $85. An industrial company would have $100 available for distribution.

At the bottom of the table you have this depletion payment made by a subsidiary. The $113 when paid to Noranda would shrink to $95. This is by virtue of the new method of calculating tax on inter-company dividends. If the subsidiary had not earned depletion then the full $85 could be passed through to the parent company. In the case of an industrial company the dividend could be passed through untaxed. In any case, in the hands of the parent company, being Noranda, irrespective of whether $113 had been earned by a sub-

sidiary or by Noranda itself, by the time the money is passed out to the shareholders—in this case we have assumed a shareholder in the 50 per cent tax bracket—the $113 becomes $71. Without depletion $85 becomes $64 when passed to the shareholder. In the case of an industrial company out of $100 available for distribution $75 is retained by the shareholder.

In this example, the mining company would have earned $28 of depletion. By the time the shareholder received the profits as a dividend, however, the net benefit of depletion would have been reduced to $7, or by 75%. In either case, total taxes are greater than would be applicable in other industries.

Under present tax rules, a shareholder of a mining company would retain $86 (compared with the figures of $71 or $64 shown above) under the same circumstances.

Our best guess is that the additional tax impact of the treatment of inter-company dividends on Noranda would average $2 million annually. To avoid this we would have to merge with all of our subsidiary and associated companies. In cases where this proved impossible, and there might well be many, then control of these companies should be sold to foreign interests to whom they would be worth more than they would be to Noranda or anyone else in Canada. The legal and other implications of this to Noranda, and we suspect to others, would be enormous and we fail to see what offsetting gains in terms of equity or revenue would justify this.

From the point of view of Noranda shareholders, however, the ultimate impact could not be avoided. As shown on the previous table, if depletion were not earned, net profits would be substantially less than those of an industrial company with the same profits before taxes. Even if depletion were earned, its benefits would largely be taxed away when received by the shareholder and his net dividend after taxes would be less than if he owned shares of an industrial company with the same pre-tax profits. Thus mining shares would be considerably less attractive to the Canadian public (but not necessarily to foreign interests) than those of companies in other industries, and the industry's ability to raise domestic capital would be seriously impaired. Of course, if its shares became sufficiently depressed in price, Noranda would become ripe for takeover by a foreign company which would not have to live under these Proposals.

Another difficult feature of the Proposals concerns income debentures, which are a common financing method in the mining industry. Income debentures are appropriate because interest is only payable if earned, a considerable advantage in an industry as risky as mining. At the same time, the rate of interest is relatively low since, because the interest has been deemed to be the same as a dividend, it has been received tax free when paid by one corporation to another. (In turn, it has not been deductible as an expense by the paying corporation). As such income would be taxable under the Proposals, this financing method would be effectively destroyed. Noranda's problem is that it presently holds or is obligated to purchase $145 million of such income debentures and would incur an additional tax burden of more than $5 million annually on the interest received on them. We obviously could not allow this to happen and would have to find some way around the problem. The point is, however, that this has been a valuable financing mechanism in our industry and would be destroyed for no real purpose.

Noranda has only recently begun to establish significant operations outside Canada, few of which are yet paying taxes. So far, all of these are in closely held companies which the Proposals would define as "Controlled Foreign Corporations". It appears that, under the Proposals, Canada would generally collect the difference between the rate of tax paid by these companies and our domestic rate of tax, thus eliminating the benefit of lower tax rates or incentives elsewhere. The real effect would be to discourage payment of dividends in Canada from such operations, or elimination of low rates or incentives by the countries involved. Our intention here is simply to record our concern about this problem, as we expect that others more immediately concerned will deal with it exhaustively.

Conclusions

The Proposals claim to recognize the unique nature of the risks inherent in the mining industry and the need for special tax treatment. However, the cumulative impact of the Proposals seems to place mining companies in a worse position than any other significant segment of the economy. Far from permitting further growth, we believe strongly that the special treatment proposed would be inadequate even to permit the mining industry to maintain its present contribution to the national economy, resulting in a net

decrease in tax revenues. If it is the policy of the government to reduce the relative importance of mining in Canada, then the Proposals may be an appropriate means to this end but we cannot believe that this is intended.

(1) Exempt Income

As has been pointed out, the present Canadian tax system generally produces somewhat higher taxes on mining operations than would apply in other comparable countries, although methods of taxation differ considerably. Mining capital is international in character, and Canada's tax system must be reasonably competitive if our industry is to continue its contribution to the growth of our country.

The present three-year period of tax exemption is an essential part of this system. At the same time, we recognize that in some circumstances it has resulted in enormous windfalls for some mines—due mostly to unusual grade or market conditions—and that these comparatively rare prizes have placed the entire system in disrepute in some circles on grounds of equity.

We suggest that this problem would be solved without destroying the effectiveness of the incentive by simply limiting the present tax exempt provisions to three years or the recovery of initial capital, whichever period is shorter.

(2) Depletion

Depletion is the other essential element in the present tax structure as it relates to mining, and is particularly important to mature and long-lived operations. It is a recognized principle in mature mining economies. It is the source of cash flow essential to the maintenance and development of ore reserves, and permits the necessary rate of return on high-risk capital. Finally, it has permitted Canadian operations to match the investment in advanced equipment and technology made possible in competing countries through similar allowances. It follows we would prefer the present system or simple modifications thereto, as it is a foundation of the existing industry.

The concept of earned depletion would cause us severe problems in terms of corporate structure. Moreover we do not understand why the "$1 for $3" ratio was chosen, nor can we understand why expenditures on existing operations were excluded. Although the Proposals give the appearance of maintaining incentives, the result would be (for mining but not for oil) an enormous decrease in the effectiveness of the incentive—over 80 per cent in the case of Noranda—and when provincial mining taxes are included the industry would pay the highest rate of income tax in Canada. Such operations as Central Canada Potash, which was founded on the economics of depletion, cannot earn one cent of depletion under the proposed system.

If the principle of earned depletion were adopted, to provide any meaningful incentive the base should include all expenditures for exploration and development plus fixed assets acquired for the purpose of gaining income from a mine, including such expenditures on existing mining operations. Moreover a $1 for $3 ratio does not provide a meaningful incentive.

The proposed system of earned depletion is further deficient by creating a serious inequity with respect to the arbitrary cut-off date of November 7, 1969 whereby some relatively new operations would not obtain any benefit. To avoid the retroactive impact on the cash flows of committed projects and to achieve equity the following formula would be essential:

(1) All mines would calculate the total of expenditures made from the inception of their operations which would have earned depletion had the Proposals been in effect, which would equal the depletion base.

(2) From the depletion base would be deducted the total of all unearned depletion claimed up to the end of 1975.

(3) A mine would then be entitled to carry forward into 1976 and beyond the difference between (1) and (2) above as earned depletion.

(3) Mining Tax Credit

We can agree with the drafters of the Proposals that no individual or corporation should be subject to taxes on income of more than 50 per cent. Therefore, whatever the system finally adopted, to the extent that a mining company would otherwise pay taxes above 50 per cent, we believe that provincial mining taxes should be credited against income taxes rather than merely deducted as an expense. In cases where production taxes or royalties are substituted for mining taxes—e.g. potash—these should be creditable under similar circumstances. Some limitation

on provincial mining taxes creditable—say 15 per cent—would be necessary.

(4) Inter-Corporate Dividends

The proposals concerning taxation of inter-company dividends obviously were devised without consideration of the enormous problems created for such corporate groupings as Noranda. On the assumption that each Canadian company pays taxes appropriate to its circumstances and that double taxes are to be avoided, there is no logic in the concept of creditable tax and recalculation as a dividend moves upward in a chain. Thus the benefits of depletion, accelerated writeoffs, etc. earned by a subsidiary or associate would be largely taxed away in the hands of Noranda. A massive reorganization could help solve the problem, but no useful national purpose would be served.

Inasmuch as no considerations of equity or revenue seem to be involved, we believe that dividends should continue to pass between Canadian corporations free of tax, and existing rules should continue to be maintained respecting income debentures.

We are concerned about the impact of the proposals on foreign income, but have no particular knowledge in this field. However, it is probable that others more immediately involved than ourselves will have suggestions in this regard.

(5) Shareholder Considerations

It would appear that shareholders of mining companies would be particularly hard-hit by the proposals. Not only would they lose the shareholder depletion heretofore available, but they would also be more heavily taxed on their dividend income than would be the case if they held shares of companies in other industries. If we understand the proposals, the end result would be to tax away the advantage of any remaining mining incentives in the hands of the Canadian shareholder. The effect on the value of mining shares and on the ability of the industry to raise capital would be serious indeed.

We suggest that the same principle should apply as with dividends between corporations—i.e. that at least so far as domestic income is concerned it should be assumed that a corporation has paid full taxes. This would not only avoid discrimination against the shareholders of companies with tax incentives but would also immensely simplify the calculation of taxes by corporations and their owners.

These suggestions by Noranda would modify the proposals sufficiently to maintain a healthy and growing mining industry, in our opinion at least. We do not believe that they can be faulted on grounds of equity since it is admitted that special tax treatment is needed. On revenue grounds they would have no significant adverse impact, since they would increase taxes from present levels and Chapter 8 of the proposals includes no allowances for increased revenue from the mining industry. The other suggestions merely rectify what must surely be unintended effects of the proposals.

We must emphasize that the views expressed are only those of Noranda Mines.

The Chairman: Now, honourable senators, we are ready for questions.

Senator Laird: This may or may not be relevant to our consideration, but you do actually own some purely industrial undertakings, do you not?

Mr. Powis: Yes, sir, that is correct.

Senator Laird: Are they extensive in that field?

Mr. Powis: Yes, sir.

Senator Laird: Could you name the proportion of the investment in purely industrial undertakings, roughly?

Mr. Powis: It is a rather difficult figure to arrive at. We own two major industrial companies, one being the Canada Wire and Cable Company Limited, the other the Noranda Copper Mills Limited. There is a fairly large industrial company in the United States called the Pacific Coast Company. We have extensive major interests in forest products, but I do not know whether that is industrial or not. We have an interest in a pulp mill in British Columbia, and through that an interest in British Columbia Forest Products Limited.

The Chairman: At the back of the docket on the second last page, you will find financial information which will give you the names of mining companies only, and separately manufacturing and other companies.

Senator Laird: I have not had a chance to read this paper; I saw it only a few minutes ago.

The Chairman: It is the second last page of the docket.

Senator Molson: What is the gross sales figure for 1966?

Mr. Powis: One has to be a little careful with sales figures, because a substantial percentage of our income is, as you can see from the chart, derived from dividends, so that the return on sales looks enormous. I do not have the figure with me, but I would guess that in 1966 our sales would have been in the order of $300 million as reported at the time. These were only partly consolidated, however, and our volume figures are to some extent a matter of bookkeeping. We have made minor changes in some of our contracts with independent mines for whom we smelt copper, which added enormous amounts to our volume figure without doing anything for the revenue end of it.

The Chairman: Any other questions?

Senator Molson: I have not had my answer, Mr. Chairman. I do not have a copy of your statement, but I assume it is broken down showing your interest in dividends, and so on. There must be a sales figure. Is there a sales figure for mining operations or manufacturing operations? What is the breakdown?

Mr. Powis: Sales between mining and manufacturing?

Senator Molson: Yes.

Mr. Powis: If I may take current figures rather than go back to 1966 I think I will be a little better off. Our consolidated sales figure would include approximately $250 million from manufacturing operations. That would compare in 1968 with total revenue, for consolidated sales if you like, of $426 million. To some extent that is deceptive, because the manufacturing operations use the copper from the mining operations, so there is an elimination if we grossed up...

Senator Molson: Inter-company?

Mr. Powis: It is an inter-company thing, so a significant portion of the sales of manufactured products is in fact sales of copper or zinc or other materials which have been mined by our operations. It is just the sale of metal in another form.

Senator Molson: The reason I am asking this is because you were comparing the rate of pre-tax profit for manufacturing in some cases in your brief, and you mentioned comparable industrial companies. I was trying to relate the profit to your gross sales figures to some extent.

Mr. Powis: If I can give you the 1968 figures maybe it will put them in some perspective. Our recorded sales volume was $426 million, in addition to which we had investment income of $17 million, coming to a total gross revenue of $443 million. Our net profit was $52 million, and income and production taxes were $34 million, so the pre-tax profit, if you like, was $86 million. Of that $86 million some $17 million was in the form of dividends from associated companies, which in the normal course are not taxable, so the apparent tax rate is deceptive.

Senator Molson: About $70 million, roughly, eliminating that $17 million from your $86 million.

Mr. Powis: Yes. We pay $34 million in taxes.

The Chairman: Senator Molson, on the second last page of the docket you may have noticed some financial information. You will find a break-down as between mining companies and manufacturing companies and you will also find a statement from 1965 to 1968, inclusive, showing the pre-tax earnings, the taxable income and the taxes paid. This is actually on the basis of what the present law is.

Then you will see the calculation of the taxes that will be payable, if the proposals become law. You will notice a substantial increase in the taxes that would be payable if the proposals are implemented into law. You will notice for those four years that there is a sum total of about roughly $45 million additional by reason of these proposals. That is in relation to the mining phase of the operation.

Senator Macnaughton: On page 2, Mr. Chairman, there is reference to the great misfortune of being grouped with the oil and gas industries, and they go on to say that accordingly their brief deals with four major points, the first being the distinction between the oil and mining industries. After that the reader is referred to Exhibit B which makes a quite drastic distinction. I wondered if the witness could develop that a little bit.

Mr. Powis: Yes, sir.

Senator Macnaughton: Put it this way: why did the drafters of the White Paper group

these two resource industries together? It seems obvious, perhaps, but why? There must have been some reason behind their doing so; and if there was, why should they not be grouped together?

Mr. Powis: I suppose the reason they grouped us together, sir, is simply that each industry had available to it the depletion allowance previously, and presumably under the White Paper still would under some circumstances. The basic problem brought out in Exhibit B, I think, and partly in Exhibit A, is that the way you spend your money in the two industries is very different. If you discover an oil field, all of your expenditures are either exploration or development expenditures. There is, with the possible exception of integrated oil companies, not a very big investment in plant. But in the case of the mining industry, while exploration expenditures are quite large, the biggest expenditure is on plant and equipment. Very often the expenditure is on plant and equipment not necessarily in the initial stages of development, but subsequently.

A good example of that is Texas Gulf Sulphur Company, which started out its mine in Timmins and after two or three years is now going ahead to build a zinc refinery up in that area to process its ores. Well, under the proposals, Texas Gulf would not earn a depletion allowance with that expenditure on the zinc refinery, although they would have done so if they had installed it originally. There is no logic in that at all, in my view. The fact is that not very many oil companies pay taxes anyway, to be blunt about it. The ones that do, of course, are the large ones such as Imperial Oil. But there will be no revenue, or additional revenue, forthcoming from the oil industries so far as we can calculate as a result of these proposals. All of the increase in revenue will come from the mining companies and, interestingly enough, there has been in the White Paper no estimate or provision in the revenue impact section for any revenues either from the oil or mining industries.

Why they grouped us together, I don't know, sir, but we consider that we would rather not be grouped together.

Senator Carter: Would it be because you are both resource-based industries?

Mr. Powis: There is a superficial resemblance, sir. We both do exploration for a natural resource, but really the resemblance ends there, in our view.

Senator Lang: You both exist on a wasting asset.

Mr. Powis: This is recognized, yes. It is a depleting asset.

The Chairman: In the United States, where they do have a depletion allowance still in existence, as I recall the definition of depletion it is that it is for the purpose of replacing the mineral asset which has been wasted or taken out of the ground. Of course, in the proposals in the White Paper no recognition has been given to that aspect, unless it could be said that the $1 paid for spending $3 is a depletion allowance, but, basically, it would not appear to go far enough, because the depletion allowance under the present law goes to the company and also to the shareholder in the dividend that he receives, recognizing that it is a wasting asset.

Mr. Zimmerman: If you look at Exhibit A, Mr. Chairman, you will see that in the top parts of the columns there are significant differences. I suggest that if this chart had been before the drafters, they would have seen what the difference was, but, if you just take a total capital exploration expenditure figure, then these come out roughly the same in those years, except for 1966, which I think reflects Texas Gulf's expenditure for mining, which is why it is much larger for that year. But the difference between the top parts of those two drafts reflects the difference in the calculations.

Mr. Powis: With respect to the depletion allowance, really what has happened to the mining industry over the past 15 years is that the provinces have stepped in and taxed it away in any case, in our view. When a mine reaches a mature state it is taxed right now, if you include the provincial mining tax rates, very close to what anybody else is taxed at. The remark was made to us by one of the people in the finance department that they were rather aggrieved that the provinces had really stepped in and taken advantage of the fact that the industry had been given a depletion allowance and had just taxed it away and that the federal Government had lost the revenues. From our point of view, we are being taxed at this rate and the industry has largely lost the benefit of the depletion allowance through the action of the provinces in taxing it away, and now it is proposed that we not only lose that depletion allowance but, as well, are faced with a tax rate very close to 60 per cent.

The Chairman: There is only one place where the money can come from.

Senator Leonard: Mr. Chairman, may I ask Mr. Powis or Mr. Zimmerman to address themselves particular to the one question of depletion on the basis of which the White Paper purports to give the reason for it, and in paragraph 544 of the White Paper, and also, I think paragraph 846, it is said that the change by bringing in the proposals, the tax on capital gains and the deduction of capital losses, is the counterpart of the depletion allowance. In paragraph 544 they say:

> Under the new system this fact would be more accurately recognized by the deduction granted to taxpayers for losses realized on shares which they have held.

In a way, what is being suggested is that the reason for the depletion allowance is now superseded by the deduction for capital loss. Would you address yourself just to answering what is implied or suggested by the White Paper?

Mr. Powis: I might say that section 5.44 deals with the depletion allowance in the hands of the shareholder, as distinct from the depletion allowance to the company itself. Certainly, on a theoretical basis, the point they make in 5.44 is valid, in that if you are paying dividends out of capital and eventually the value of your shares declines, you can take that as a capital loss. However, that does not really bear on the overall question of the depletion in the hands of the company.

I think the major argument we would make there is that as things stand at the moment, while there is ostensibly a depletion allowance, the tax rate we are presently paying is very close to the level everybody else is paying. And really you can argue, I suppose, if you reduce it to its extremity, the Government can tax you at 100 per cent and, on that basis, your shares will be worthless and you can write the whole thing off for tax purposes and get your money back anyway. But it is not a particularly promising way to try to further development.

The Chairman: If you take the present system, under which the shareholder is entitled to 10, 15 or 20 per cent depletion allowance which he may deduct from the amount of dividend that he receives from a mining company, depending on the nature of production, he has money in hand and is able to keep part of it without having it subject to tax. To suppose it is a proper alternative that if the value of the shares goes down, for whatever reason, maybe he can always sell and write off the loss, of course, there is the presumption there that he must have some income. If he wants to hold the shares, where does he write off the loss? He must have other income against which to write it off. Whereas he is not faced with that problem with a depletion allowance; he gets his dividend and depletion allowance which gives him a tax-free portion of that dividend.

Senator Leonard: It is a hypothetical *quid pro quo*.

The Chairman: Yes. I think it sounds more impressive, and I always get frightened when they talk of losses and writing losses off because, first of all, who wants losses; and, secondly, the very people who suffer them are not usually in a position to take advantage of them.

Senator Everett: Have they not taken paid dividends as a return of capital in tax terms?

Mr. Powis: I suppose you could say, yes, in that if you make the assumption, which is reasonably valid, that each of the mines presently operating is eventually going to die, then we are paying dividends out of revenue from wasting assets, if you like. On the other hand, to the extent that is a loss on your books really depends on the price you pay for the asset to start with.

Senator Everett: Is that in terms of section 8.46:

> ...but if such dividends in fact reflect a return of capital the new provisions regarding the deduction of capital losses would be available.

I wonder under what circumstances a mining company could do this. I think real estate holding companies have done this, where they pay no tax but they pay—and Mr. Gilmour will correct me if I am wrong—a cash dividend. In other words, their depreciation is such that they pay no corporate tax but continue to pay a cash dividend out. Presumably, in tax terms, that is a dividend out of capital.

The Chairman: Well, dividend is dividend.

Senator Everett: Section 8.46 refers to a dividend which is in fact a return of capital.

Senator Leonard: It suggests because of the presumed depletion that in point of fact divi-

dends may be paid in part out of capital, that part of the capital represented by the depletion allowance.

Senator Everett: What it in effect says is that if a company shows no taxable income, a dividend would then presumably be, in tax terms, a return of capital.

Mr. Zimmerman: I do not think, in our affairs, we have done anything but paid dividends out of earned income until the company wound up.

Senator Leonard: After depletion?

Mr. Zimmerman: After depletion and after taxes.

Senator Leonard: Mr. Powis suggested there may be some validity in section 5.44 but, quite frankly, I agree with the Chairman. I do not think the possibility of being able to deduct a capital cost makes up for a present depletion allowance to shareholders of a company with wasting assets.

The Chairman: With the permission of the committee, I would ask Mr. Gilmour to answer your question, Senator Everett.

Mr. Gilmour: In the accounting sense, I do not think any accountant could agree with the statement in the White Paper. A company, such as Noranda, has incurred expense to explore and develop a mining claim. When it prepares its accounts it writes off the cost of its mining claim by a book charge for depletion. In other words, it capitalizes the costs and as it digs the metal out it amortizes the cost of the mine on its accounts, and that charge with regard to amortization or depletion, as it is commonly called, is charged against the reported earnings of the company and the company, in turn, shows the net profit. Therefore, in accordance with accepted accounting principles, this company has made provision on its accounts for the wasting asset. Therefore, any dividend it pays is not a dividend out of capital.

There could be rare exceptions where there might be a mining company with a single mine where the directors and shareholders have agreed that this is a once-and-for-all operation. I have never seen such a company, but it could be that there would be no book charge for the amortization of the cost of the mine, and in that case there would be a true dividend paid out of capital.

Under the White Paper proposal these are tax as distinct from accounting proposals. The White Paper has suggested that there should be no true allowance for a wasting asset. Instead there is a provision for a so-called depletion provision which is based not on the wasting asset but on an artificial concept that for every $3 you spend for additional exploration you shall have this earned depletion which gives you absolutely no write-off for the cost of existing producing mines.

Now, in the past there has been this rough and ready depletion allowance of approximately 33⅓ per cent of your earnings from an existing mine. That is to be abolished, and instead we have this artificial—if I may use that word—concept that you get nothing for an existing mine unless you keep spending dollars for new exploration that may never produce anything, and for that you will get one-third. So, between a proper accounting and tax there is a great gap.

Senator Molson: The new concept, Mr. Chairman, is not really depletion. No matter what it is called, it is not depletion.

The Chairman: That is why I referred to the U.S. concept which is tied to wastage, and to our concept which is tied to the fact that there was a wasting asset, and which is true depletion. But, this is not depletion at all. It is a misnomer to call it depletion.

Senator Connolly (Ottawa West): I think that should be emphasized very strongly, Mr. Chairman.

Senator Leonard: Then may I ask Mr. Gilmour this question: Is not depletion quite similar to depreciation. It would be, I would think, quite out of order to suggest doing away with the depreciation allowance as is now allowed in return for the fact that possibly some day a shareholder might get a capital loss as a result of the asset having depreciated. Is not that an analogy?

Mr. Gilmour: Yes, Senator Leonard, there is really absolutely no distinction between so-called depletion and depreciation. There is an historic difference that depreciation is the amortization of the cost of a tangible asset that wears itself out in the course of production. Depletion historically relates to the amortization of cost.

Senator Leonard: But from the standpont of what we are discussing here there is really no real distinction at all.

Mr. Gilmour: That is right.

Senator Leonard: And they should not be treated differently.

Mr. Gilmour: That is right, sir. There is no distinction in fact between the two items. The White Paper however proposes to continue capital cost allowance subject to a review in the future, but it also proposes to wipe out the traditional depletion allowance, which is comparable to depreciation.

Senator Leonard: Mr. Powis, you may not be quite sure there is some validity in the proposal that is made, as you mentioned in the beginning...

Mr. Powis: No, sir, I did not mean to imply that supported the statement made in paragraph 5.44. The statement looks pretty good only theoretically, but the way it works out in practice is something entirely different.

Senator Everett: Would you say that in Noranda's case it will work out...

Mr. Powis: Taking Noranda's complicated case—and here we have a distinction between depletion allowed to the shareholders, and depletion allowed to the company—this concept of earned depletion is going to be an extremely difficult thing for us to live with, if it is put in. In the first place I do not think it is worth very much on a three to one basis. Secondly, there is the problem of who has earned that depletion. We could have one company that is developing a new mine...

Senator Everett: That is another question. We were talking specifically of the depletion allowance to the shareholders. In your judgment the statement made in paragraph 8.46 and 5.44 that capital losses would offset the change which...

The Chairman: Do you mean "substitute for it"?

Senator Everett: They say that the problem of depletion is that it does not produce creditable tax, and the White Paper says this is offset by the shareholders' loss of deductibility. I am asking you whether in the case of Noranda you feel this would have any application at all?

Mr. Powis: No, sir, because...

Senator Everett: Thank you.

Mr. Powis: ...we are not in business to produce losses for our shareholders. We are trying to increase the value of the company, and its value to the shareholders.

Senator Everett: In fact, you cannot see producing losses for your shareholders?

Mr. Powis: We are trying not to. Mr. Zimmerman would like to comment on that.

Mr. Zimmerman: Mr. Chairman, I just want to say that some of us tend to confuse the Norandas of the world with some of the more promotional mining companies. This question of a capital loss provision being available to a shareholder may be all right for the fellow who is dabbling in penny stocks, but for a person who is investing in Noranda I do not think it is a factor. Very often we get tarred with the same brush. We are a major industrial enterprise, and we do not know what is going on in the stock market day by day, notwithstanding what anybody thinks. It seems to me that these people in the Department of Finance and everywhere else think that we are worried about stock values, and so on. We are there to earn a profit, and as the profit increases then the share value increases.

Senator Leonard: Mr. Chairman, my last question is in connection with the figures given at the bottom of page 3 of the Noranda brief. The actual taxes on income from Noranda in 1968 amounted to $7.4 million. Under the new proposals they will be $9.5 million, an increase of $2.1 million. Have you any rough breakdown to show under what particular parts of the White Paper proposals this increase of $2.1 million comes? Is it in respect of depletion?

Mr. Powis: It is strictly the depletion allowance.

Senator Leonard: Entirely the depletion?

Mr. Powis Yes.

Senator Leonard: That makes an increase of $2.1 million in taxes for 1968, then?

Mr. Powis: That is right.

The Chairman: Senator Leonard, you made reference to paragraphs 5.44 and 8.46.

Senator Leonard: Yes.

The Chairman: I would suggest for Mr. Powis' consideration paragraph 5.31, whch deals with the proposal to phase out the

three-year tax holiday. The presumption in paragraph 5.31, as you will notice, Mr. Powis, reads in this way:

> Once the provisions concerning exploration and development costs...

The White Paper proposal is that you can write them off as fast as you incur them.

> ...the costs of acquiring mineral rights and the costs of mining machinery and buildings are in place, taxpayers can be pretty well assured that they would not be taxed on mining ventures until after they recover their investment.

And then it goes on to say:

> Having provided that assurance, the government proposes to phase out the present three-year exemption for new mines.

In other words what they are saying is that they are proposing a formula to determine at what stage a mining venture is profitable and, therefore, the stage at which it should be subject to corporate tax like any other corporation.

Now, what comment have you, Mr. Powis, on this paragraph, and the weight which is attached to these benefits that are provided under the White Paper?

Mr. Powis: Well, sir, I might say that if the Government in some manner can guarantee the success of an exploration program there might be a little bit of validity in that. The fact is that you can go on year after year—and in Noranda's case, for ten years—and not find a darned thing in your exploration program, and you could go on for another ten years in the same way. So there is no provision in the White Paper that guarantees that you will recover the cost of an exploration program.

The Chairman: What they do say, though, is that when you have the money or the income to take care of these costs, at that time you can apply the income in that direction and you are not subject to tax, or you are not deemed to be profitable until you have done that.

Mr. Powis: If you have been lucky enough to get the income out of the exploration program, this is true. The other thing I would say is that in international terms...

Senator Everett: Just a minute. Does the income have to come from the exploration program?

Mr. Powis: We can write off our exploration expenses against normal income, but, I might say, in the normal course we cannot write it off against our provincial mining tax.

Senator Leonard: Is there any real difference between what you say in your brief on page 7 and what the White Paper says in 5.31? On page 7 you say:

> .this problem would be solved without destroying the effectiveness of the incentive by simply limiting the present tax exempt provisions to three years or the recovery of initial capital, whichever period is the shorter.

Is that not what is intended by 5.31 of the White Paper?

Mr. Powis: Even in the absence of a three-year tax exemption period the present system permits you to write-off 100 per cent of your so-called development expenses and on a 30 per cent declining basis balance your plant equipment. That rate now pretty well provides that you would not pay tax, even without a tax-free period, until you had recovered the capital involved in that specific operation.

What we were trying to get at in this section of the brief is that this system of tax exemption has fallen into some disrepute in some circles, because there have been companies which because they found bonanzas really got their capital back several times during the tax-free period and then had write-offs afterwards and got enormous windfalls. I think Pine Point was one. When they put Pine Point in production they had no idea they would run into the high grade ore that they did run into, and they got their money back in a very short period of time. This sort of thing drives the tax collectors up the wall. Rather than throw out the baby with the bath water, it seemed to us it might be sensible to say, "All right, if you don't like this sort of thing restrict the tax-free period to recovery of capital or three years, whichever is the shorter period."

I think the tax-free period has to be looked at in the overall context of the tax system as it relates to mining and in international terms. For example, in Canada we have a federal tax provision which relates to mining. We have a tax exemption period plus the depletion allowance. In the United States there is no tax exemption, but there is a generous depletion allowance. Over the years the two systems very well equate. If you take away the period of tax exemption and leave

the present depletion system it would impose on Canadian mining a very much higher rate of tax than is paid in countries like the United States and Australia. To take this provision away as proposed in the White Paper is merely to leave us in a position where the White Paper has, in effect, said that we need special tax provisions because of the unusual nature of the industry itself.

Senator Leonard: I do not understand that this is what the White Paper does propose. This is why we have had depletions. This is a three-year exemption period.

Mr. Powis: That is right.

Senator Leonard: You suggest making this shorter, either three years or when the investment has been recovered. That seems to me to be an identical proposal with the one the White Paper makes in 5.31, where they say, "We give you an assurance that you will not be taxed until you recover your investment". Will that not take the place of the three-year period?

Mr. Powis: No, sir.

Senator Leonard: Am I wrong in that?

Mr. Zimmerman: That is what it says, yes sir.

Senator Leonard: In other words, it seems to me you are both in agreement on the three-year period.

Mr. Powis: No, sir, in no way. Under the present regulations a mine is exempt from tax on income for three years. When it becomes taxable it is allowed to write off under the regulations its capital costs in the normal way. It depends on the circumstances what comes out of this, but in effect the normal mine may have run along for three years, and maybe its profits equalled, let us say, one-third of its total investment. At this point it is still entitled after the end of that three-year period of tax exemption to write off at relatively high rates its expenditures on exploration, development and equipment.

The Chairman: You means as pre-production expenditures, and also the depreciation which it might have had in the meantime?

Mr. Powis: That is correct. What this White Paper does is completely eliminate the three-year tax-free period. What they say in 5.31, is certainly true; essentially it is true under the present tax regulations, in that even if we did not have the tax-free period the write off provisions would keep us out of paying taxes until such time as we had essentially got our capital back. The same is true of a pulp mill and a lot of other highly capital intensive types of investments.

Senator Everett: So under the present arrangement you get a complete write off under the write off section and the three-year exemption is a bonus on top of that?

Mr. Powis: That is correct.

Senator Everett: And they are removing the bonus?

Mr. Powis: They are removing the bonus. What is provided here will under certain circumstances be slightly more attractive than the present system of write offs, but not of appreciable value.

Senator Leonard: Then what is your proposal when you say:

> We suggest that this problem would be solved without destroying the effectiveness of the incentive by simply limiting the present tax exemption provisions to three years or the recovery of initial capital .

The recovery of the initial capital may be in one year or two years. Is that not right?

Mr. Powis: That is correct, but what we are proposing is that essentially we stick to the present rules, but in cases where it would create an enormous windfall for a company we would restrict the length of the period to the recovery of capital. It seemed to be a simple measure of this restriction. I can understand why tax collectors would be driven crazy by looking at figures which showed a company had spent $50 million developing a property and in the first year had completely tax-free earnings of $100 million. This does not happen very often and when it does it seems reasonable to limit the incentives.

Senator Beaubien: What you are saying is that if I spent $50 million on a mine and I got the $50 million back in two years, instead of getting a tax-free period for three years I would get one of two years only?

Mr. Powis: Yes, that is correct, sir.

Senator Beaubien: Then you start writing it off in the normal way?

Mr. Powis: That is correct.

The Chairman: There is a question I wanted to ask arising out of this, and you hinted at it. The attraction or format for raising money for development of a mining property recognizes the risk nature of the venture. Is not a great attraction in the format, for raising debt money in particular, the fact that there is a tax holiday and a depletion allowance?

Mr. Powis: Oh yes.

Senator Cook: How does our depletion allowance compare with those of other countries? Is ours more generous or less generous?

Mr. Powis: Others are essentially more generous, sir. Our depletion allowance is simply one-third of mineral income defined. In the United States, for example, depletion is based not on your income but on your gross revenue. It is a percentage of gross revenue. The allowance is restricted to a maximum of 50 per cent, as I understand it, of your mineral income, and, generally speaking, that is what it is: 50 per cent of mineral income. So the depletion allowance rather than being a third is one-half, as a general rule.

On the other hand, they do not have the three-year tax-free period.

But, depending on the circumstances, the United States system is really more attractive for a mine with a long life. Quite obviously you get mining operations in Canada which may not last more than three years, and, if they have been profitable, they might never pay a tax. A big operation which may recover its capital over a long period of time, and which has a long life, over its life would pay considerably less taxes in the United States than it would under our present system. Under the proposed system, well,...

Senator Cook: How about Australia?

Mr. Powis: Australia is, I think, generally similar.

Mr. Zimmerman: It varies a little bit, depending on what metal is involved. The effect for us is really shown on page 3, where we show the comparison with Gaspé.

Mr. Powis: I think, essentially, the Australian depletion is better than ours.

Senator Cook: Generally speaking, ours is not overly generous at the moment.

Mr. Zimmerman: The net effect of all our present incentives is about the same as that of the United States and Australia.

Senator Molson: Mr. Chairman, in the case of an old, well-established mine, of which we have a few in this country, mines that have gone on for a very long time, under the system of depletion which has been in effect have the proprietors in effect recovered more than or many times more than their capital?

Mr. Powis: Generally speaking, yes.

Senator Molson: Over a long period? I am speaking of some of the really old mines that have continued to run.

Mr. Powis: Generally speaking, yes, sir.

Senator Molson: They would, eh?

Mr. Powis: On the other hand, if the name of the game is only to barely recover your capital, you have no business developing something. You have to do more than just recover your capital in order to make something viable. In the case of Gaspé Copper, for example, sir, you will note that the initial expenditure is $48 million. This is on page 3. Up through the end of 1968 we had earned before taxes $96 million, and after taxes $68 million. So we certainly recovered that initial capital in terms of profits, and this, of course, is after depreciation, which can be considered as part of the cash flow. So Gaspé Copper has been a successful venture which has more than recovered its capital, and it still continues to take depletion.

Here again we will note that in 1968 they did pay effective taxes of 43 per cent; in 1969 I think it is higher than that, and in 1970 it will be higher again as the impact is felt.

Senator Connolly (Ottawa West): I have two questions. The first one arises out of Senator Cook's question about a comparison between the U.S. treatment and the Canadian treatment in respect of depletion. Is it a fact that originally the U.S. laws, as drafted, wiped out depletion but then, upon review by one or other of their houses, I forget which, the old system which had originally been proposed to be wiped out was in fact restored? And is it not true that that is about to become the law of the land? In other words, for mining or for the mining industry, perhaps the amount of depletion has been slightly reduced, but,

broadly speaking, the law is to remain the same.

Mr. Zimmerman: That is correct.

Senator Connolly (Ottawa West): That is correct?

Mr. Zimmerman: Yes.

Senator Connolly (Ottawa West): In other words, they did have a go at what is proposed in the White Paper in Canada, but upon reflection changed the rules and restored the old law, perhaps reducing the amount of depletion.

Mr. Zimmerman: I am not sure they proposed to wipe it out altogether, but the remainder of your conclusion is correct.

Senator Connolly (Ottawa West): All right. If they reduced the depletion substantially in the first round, they restored it substantially in the second round.

Mr. Zimmerman: That is right.

Senator Connolly (Ottawa West): And that is the way the law emerged from Congress for presidential approval?

Mr. Zimmerman: That is right.

Senator Connolly (Ottawa West): Mr. Chairman, the other question I have arises out of what you yourself had to say about the word depletion. Here I do not talk of depreciation, because I think that is a different concept, perhaps in the sense that Senator Leonard mentioned it, but, talking now about depletion, the Chairman described it, if not defined it, as a replacement or method of replacement of a wasting asset.

Now, you used the example of Texas Gulf Sulphur, and it seems to me that that was a case where, in order to make a very valuable property viable as an undertaking, they proved up a tremendous amount of ore and as a result of proving up the ore and finding an outlet for the product of that mine they were able to get a very large amount of financing that was required. And depletion as well as the three-year tax exemption was a factor in that financial operation.

I don't know whether you have similar situations in any of your companies in the Noranda Group, but, if you have not, perhaps you would restrict yourself to the case of Texas Gulf Sulphur. In that case, assuming that the ore body was going to last for 75 or 100 years, or perhaps even longer, and assuming that depletion is wiped out, there would be no incentives, I take it, for that company to look for new ore bodies. Certainly, there would not be the money available for that company to go and look for further deposits. What they want to do is to work out that ore body and recover their capital and pay their dividends. At the moment they are not concerned about finding new ore bodies. They have got all they can do to develop the property as they found it.

It seems to me that, if that is the case, the rules having been changed in the middle of the stream, their operation is going to be very adversely affected.

Mr. Powis: I think it would certainly be hard hit, sir. Texas Gulf, of course, is an example of a very rich mine. I suggest that if I were running Texas Gulf—and I am not—what I would be inclined to do, if these proposals came into effect, would be to go south in terms of development. Most mining companies really take the money that they have got from depletion and turn around and spend it on development of other mines or exploration.

Senator Connolly (Ottawa West): But they would have no incentive to do that.

Mr. Powis: They would have no incentive to do that here, sir. That is right. It would be very much more attractive to Texas Gulf, which, after all, is an American company, to take its money out of Canada to the extent they wish to engage in mineral exploration, be it in the United States, Ireland or some other place. That is certainly what I would do, and particularly in their case, because in the United States you are allowed to write off the cost of foreign exploration against domestic income, which we do not have the privilege of doing.

The Chairman: In charging, a United States resident has to bring his profits into his books in the United States from foreign operations, whether he actually brings them home or not. As I understand it, there is an exception there in the case of developing countries. We do not have anything of that kind here, because in a developing country you may have a tax holiday. Therefore, if your law required the company to bring home the profits or the income from the development of a property in a developing country or at least account for it for tax purposes, by virtue of the tax holiday they would have no offset of the tax, even

under our system here, and when they bring that money home it would be subject to the full tax.

This is one of the points I think the minister addressed himself to in the Commons committee and, as I understand it, he described it as a problem, and it is a problem. We are putting money into developing countries, and if some of our people go into them and work in those developing countries, because there are attractive features by way of tax holiday, for instance, and then you lose the whole benefit by taxation, I do not believe the developing countries would be very appreciative of our attitude in blowing it in both directions. I find no provision here to deal with that concept, and there is a lot of development going on outside Canada in Canadian companies and operations in developing countries where they have the benefit of tax holidays.

Mr. Powis: In connection with what you were saying, I think a good example in the Noranda group is the Brenda Mine in the Okanagan Valley of British Columbia. This was found and developed to a certain stage by other people who brought it to us for financing. Just after we had agreed on the basis of financing the Brenda mine the report of the Carter Commission came out—and, I submit, the proposals contained in the White Paper and the Carter Commission proposals, as they relate to mining, are pretty similar. We took another look at the Brenda mine on the basis of the Carter Commission proposals and concluded it simply was not viable and the rate of return was not large enough, because of the elimination of the three-year tax holiday plus the depletion. At that point we announced, and unfortunately got more publicity on it than we expected, that we would have to defer or withdraw from the financing of the Brenda mine, at which time the guarantee by the Government of the continuation of the tax-free holiday until the end of 1973 or 1974 was put in, and this is the only thing that made the financing of the development of that mine viable. Had we been faced with the certainty of the Carter Commission proposals or these proposals, we would not have developed this mine.

Another example in the case of our company is a potash mine we developed in Saskatchewan, and we spent $90 million on the development of it. There is no way we would have gone ahead with that. We started in 1966 and, as is the case in such operations, it has just come into production now. Had we known that we were going to be faced with this sort of thing there is no way we would have proceeded with it; the return would not have been adequate.

Senator Connolly (Ottawa West): We were discussing earlier the problems arising out of the proposals of the White Paper, particularly in connection with what Senator Molson calls the older mines, the mines that have a life expectancy of 75 to 100 years, and in the period of time in which this mine continues to exist there is a radical change in the technology, where you have to change the method of treatment of ores, where you have to put them out in different forms to make them saleable on the markets, not only here but on the world markets, the depletion would help you here and would continue to help you. Is there anything in the White Paper that would give you any help in a situation like that, other than depreciation for the installation of buildings and machinery?

Mr. Powis: There is nothing. This is a problem, I think, which is being faced by a couple of companies right now, the Iron Ore Company of Canada being a prime example. As a result of changing demands in the world for the type of iron ore being produced, I understand that company requires a substantial investment in peller plant. It is my understanding that the shareholders have agreed to put up the money on the basis of the present tax laws; and on the basis of the proposed tax laws they will not and cannot afford to.

Senator Connolly (Ottawa West): You have not any companies like that?

Mr. Powis: Yes, we have one project we are examining at the moment, the feasibility of considerably expanding the operations of the Gaspé copper mine to treat lower grade ore, which up to now we considered to be waste but, because of changing technology and efficiency, we can look at now as being ore.

Senator Connolly (Ottawa West): And beneficiate it?

Mr. Powis: Yes. This woutd involve an expenditure of $50 million or $60 million. There is no benefit on that at all in this White Paper. We cannot earn depletion on the expenditures because they would be on an existing operation.

Senator Connolly (Ottawa West): In passing, as honourable senators know, I have just

returned from Russia and I have been talking there with some of the people who have been working particularly in their northern areas and Siberia in the process of beneficiating low grade ores, and as they get older it is becoming very much of a problem for them.

Mr. Powis: Yes, it is a very serious problem.

Senator Burchill: I understood you to say that the provincial governments, by mining taxes or royalties, were taking away depletion charges.

Mr. Powis: That is correct.

Senator Burchill: How do the provincial taxes compare in the various provinces? Are they pretty well in line?

Mr. Powis: Not necessarily. In the three provinces which are, if you like, the large mineral-producing provinces in Canada—being Ontario, Quebec and British Columbia—they are 15 per cent. They are calulated on a slightly different basis, with different deductions, allowances, and so forth, but the rate is 15 per cent.

Senator Beaubien: 15 per cent of what?

Mr. Powis: Of taxable mineral income, however the individual province defines "mineral income."

The Chairman: Since it must be a direct tax, I understand, on the value of the ore at the pit head, you can be sure they have one eye looking at the full realization and they have a formula for establishing what the value is of the ore at the pit head, with a lot of exclusions, etcetera. So, the provincial mineral tax amounts to a very substantial amount of money.

Senator Burchill: Just a minute now...

Senator Leonard: We have not come to the most important province yet.

Senator Burchill: Yes. I want to know how New Brunswick stacks up with that Brunswick mine down there.

Mr. Powis: It is my recollection—I am sorry that I do not have in my mind the rate in New Brunswick, but I believe it is lower than the rate in Ontario, Quebec, and British Columbia.

Senator Beaubien: You said the right thing.

The Chairman: That is the Maritime reputation.

Senator Lang: Mr. Chairman, the witness was comparing the tax rates in the United States, Australia, and Ireland. I know that considerations may be radically different, but Mr. Powis, would you care to comment in a general way on the tax rates that you experience in South America?

Mr. Powis: Well, sir, let us take Mexico as an example. We have a profitable mine operating there, and I think the tax rate on that mine operation is on the order of 35 per cent. That is just a flat rate of tax.

Mr. Zimmerman: It changes every week, though.

Senator Lang: Do you have to disseminate some of the equity?

Mr. Powis: Actually, we sold 51 per cent of the equity to Mexicans in Mexico. The rate of tax in Latin America generally, and many of these developing countries, is subject to negotiation.

The Chairman: That is right. It is in Mexico.

Senator Lang: I am just wondering at what level it is.

Mr. Powis: We have industrial operations in Latin America, and I do not think that anywhere we pay taxes of more than 35 per cent on those. In terms of mining operations I think the tax rate is about the same.

Senator Lang: Is there any country in which you operate where you pay more than the Canadian rate?

Mr. Powis: No.

Senator Everett: I have two questions, Mr. Chairman. I note that the White Paper proposes to make the cost of mining leases deductible, and I gather they are not now.

The Chairman: The cost of what?

Senator Everett: The cost of mining leases.

The Chairman: The acquisition of mining rights?

Senator Everett: The cost of acquiring. It also proposes that the write-off on machinery and buildings will be either the present 30 per cent, or as fast as you can make income. It will be at your option. Can you tell me

whether those two amendments will contribute to Noranda's earnings?

Mr. Powis: No, I do not think they will. In terms of the cost...

Senator Everett: Perhaps I should put that the other way around and ask whether they will contribute to the value of Noranda shares.

The Chairman: That is another question.

Mr. Powis: The cost of acquiring mineral leases is not really a significant factor in our operation. I do not know how it applies to the industry as a whole, but generally speaking, the way you go out and acquire mining leases is by going out and staking them, and that is already a deductible expense. I can think of only one case in which this would be of benefit to us. We did buy a lease in Saskatchewan for some $7.5 million from another company. It would have been helpful in that particular case, but it is not a significant element in our overall operation.

The Chairman: At present it is a capital item?

Mr. Powis: Yes.

Senator Everett: Do you not have prospectors who have discovered claims come to you for financing, and do you not buy the claim at that point, or a portion of it?

Mr. Powis: What happens, if a prospector discovers a claim, is that he brings it to us for development, and we will form a new company. He will get a percentage of the stock in that new company. At that point of time the shares that he gets are worthless, or virtually worthless, and they only become valuable to the extent that we discover a mineral deposit of value on the property. So, the cost of issuing pieces of paper—I do not know what value you could ascribe to that stage of the venture, but it would not be very great.

The Chairman: And he usually gets vendor shares which have no real market.

Mr. Powis: Yes, so there is no particular virtue in that proposal from our point of view. With respect to the fast write-off the circumstances in which you can write off at the rate of 100 per cent occur only if you are a new mining operation. While this is certainly better than nothing, it is not really terribly significant, because under the present tax system you can write off in any case the cost of your machinery at the rate of 30 per cent on the diminishing balance, and the cost of sinking shafts, et cetera, are written off in any case. All they are providing for is a change from the write-off of 30 per cent on the diminishing balance to a flat write-off in the case of a new operation, but you can take your 30 per cent depreciation on the diminishing balance right now, and then fill in with your 100 per cent write-off on development.

Senator Everett: It seems to me that one of the complaints you make in your brief is that in the case machinery and installations put in after the mine is operating there is not...

The Chairman: They are not subject to this benefit.

Senator Everett: The impression I got from the brief is that they should be part of exploration and development expense.

Mr. Powis: What we are referring to here is that if the Government is going to insist on this concept of earned depletion—you can get "Brownie" points on this depletion, if you like, by spending money—it is illogical to just limit that to the money that is spent to develop the mine, and not include the things that I referred to in the example of the Texas Gulf zinc refinery which they were going to put in at a cost of $50 million three years after they went into production. If you are going to have depletion then that should be just as much included in the calculation of earned depreciation as the original expenditure.

Senator Everett: So the two proposals I have referred to really do not, in your judgment, add to the value of your shares at all?

Mr. Powis: No, sir.

The Chairman: Mr. Powis, I would like to ask you to address yourself to the question of what effect the proposals in the White Paper would have on the development of marginal properties.

Mr. Powis: Well, nobody develops a marginal property because it is marginal. It is usually developed in the hope of finding something better.

The Chairman: Let me give you an illustration. The first uranium property that came into production was Pronto Mines. They had a well defined ore body and a pretty exact knowledge as to the extent of it. They had a commercial rate which was just marginal, and they had a productive capacity which

would give an indicated life of about eight years. Certainly the attraction for debt financing on that was the tax holiday in the depletion allowance, and on that basis they were able to raise the money because in the prospectus you could reflect in your cash flow the benefits of a three-year tax holiday and the benefit of the depletion allowance which would make the property attractive, even though the rate of return on a per ton basis might be pretty close to marginal.

Those figures worked out so perfectly that the mine ran out of ore in eight years, and that was it, but the money could not have been raised in the first place, and the $10 million in purchasing power that was put into the Canadian economy would not have been put into it.

Mr. Zimmerman: They also had a guaranteed sales price, which made a little difference.

The Chairman: Yes, that is right.

Mr. Powis: I think you are quite right. The proposals would eliminate so-called marginal properties. One of the important things to remember about marginal properties is that they very often develop into something else. The Horn mine, which has been the foundation of Noranda and has been our lifeblood for 40 years, started as a highly marginal proposition. It was only after they got into production that they found the main ore body, which proved to be the mainstay of Noranda for 40 years. Certainly under these proposals the Horn mine would never have been developed, and perhaps the deep ore body never found.

The Chairman: Would you agree that those who are in the market and are interested in supplying risk capital for the development of mining properties have an education or a standard for making financing attractive, and would you say an essential part of that is the existence of a tax holiday and depletion allowance?

Mr. Powis: Yes, sir.

Senator Everett: Under the depletion concept put forward by the White Paper, you say the result for mining, but not for oil companies, would be an enormous decrease in the effectiveness of the incentive. Could you explain why that is so?

Mr. Powis: It is really the nature of expenditures in the two industries. I am not referring here to things like refineries, but just to the producing element of the oil industry. In the oil industry their expenditure all, I think almost without exception, qualify for an earned depletion base. In the mining industry, a great preponderance of expenditures on development and suchlike really would not qualify, because they are such things as the Texas Gulf expansion and the Gaspe Copper development to which I referred earlier. It is because the natures of the two industries are so different that virtually all of the exploration development expenditures by oil companies—once an oil well is producing you really do not do very much else, you just run it out...

Senator Everett: The exploration and development expenditures of mining companies are not very great?

Mr. Powis: They are not relatively as great.

Mr. Zimmerman: As a percentage of total expenditures.

Mr. Powis: If you look at Exhibit A, you will see that the mining industry spent on exploration and development as such less than the oil industry, but it is still a substantial amount.

Senator Everett: Was it nothing in 1967-68?

Mr. Powis: I am sorry, we did not have the figures for that period. In the oil industry we could illustrate the expenditures, the land costs claimed—this is not a good example; it is not in Canada—by looking at the enormous amount of money laid down for the development of the north slope in Alaska which we have all read about. Their land costs plus exploration expenditures plus capital expenditures are usually incurred prior to production, whereas in the case of the mining industry the exploration development expenditures and a portion of the capital expenditure is spent before the mine comes into production, but a very significant percentage of those expenditures are made on existing mines after they have been in production for quite a period of time.

Senator Everett: I see that $1 billion in 1967 was spent on capital expenditures in the mining industry. Have you any idea how much of that would not be allowable for the depletion base?

Mr. Zimmerman: We would have to know how much of that is in addition to the existing plant, how much is new plant.

Senator Everett: I just wondered on what basis you made the statement in your brief.

Mr. Powis: On Exhibit B there are two green lines, one is the depletion claimed by the mining industry under the present tax system, and the lower dotted green line is the amount of depletion that the mining industry could have claimed under these proposals. The blue line is the depletion claimed by the petroleum industry.

Senator Everett: It is taxes payable by the petroleum industry, is it not?

Mr. Powis: The two figures happen to be the same. It is one-third, one-third and one-third. If you have one-third depletion you also get one-third tax. The blue line is depletion claimed as taxes payable by the petroleum industry under the present regulations, and it would be exactly the same under the proposed ones.

Senator Cook: Apart from whether or not the petroleum industry can live under the new rules, would you know how the new rules stack up internationally for petroleum? Is this less generous or more generous than in other countries?

Mr. Powis: I am no real expert on oil.

The Chairman: Perhaps it would be helpful to the committee if Mr. Gilmour took a moment to explain how the taxation works in respect of oil.

Mr. Gilmour: Where you have an oil, petroleum or natural gas company as contrasted to mining, under our present laws all money spent in purchasing an oil lease, and of course drilling it, is treated as a pre-production expense, and you are allowed to charge this pre-production expense against your first dollar of income, be it income from a sale of oil, gas or of anything else that may be in your company. Then, as long as you are exploring and proving up additional areas you are able to spend this money and save it as an expense until such time as you get income. If and when you get income, you are entitled to charge everything you have spent up to your income.

Over and above that, when you have written off all your pre-production expenses, and also written off all the costs of your tangible assets, you are entitled under our law to what is called profits depletion. That depletion is based upon your oil income, which consists of your income over the year minus the pre-production expenses that you have charged for that year, and minus a capital cost allowance or depreciation that you have charged for the year.

The result is that in Canada today, where our oil industry is essentially proving up and saving new areas, they get no profits depletion. There will be exceptions. Imperial Oil is obviously an exception, but just about every other major oil company gets no depletion whatsoever now.

Under the White Paper proposal these oil companies will be entitled to this earned depletion. And under the White Paper proposal this will be a deduction also accruing for the future. So that you will have this earned depletion because you have spent money and it would therefore appear that the oil industry is getting a benefit, because in the past you have never been able to claim profits depletion, and, in the future, you will be able to save earned depletion.

Whereas in your mining company here your depletion to date has been a rough and ready measurement of the exhaustion of the mine. As was pointed out, if you have a long-lived mine, then your rough and ready depletion allowance will probably recover you more than 100 per cent of the cost of your mine. The depreciation of tangibles, of course, levels off when you have recovered 100 per cent. You stop getting depreciation. But there is this very basic distinction between oils and mines, because I guess it is the difference in the industry, where our oil companies are continually exploring and proving areas which do not necessarily come into production until somebody decides they should. All these expenses are savable and deductible when you decide to get income from your properties. Then, of course, after you have written off all your expenses against the income, then the profits depletion starts and very few oil companies today have ever had occasion to claim profits depletion, because of their exploration expenses. I feel the major distinction that the committee will observe as briefs come in is that in the mining industry under the White Paper earned depletion will be there. Mines have always claimed profit depletion. Oils rarely have claimed profit depletion, and, in effect, they will be getting somewhat of a bonus to encourage them now to explore further and save their earned depletion. So there is a major contrast between the two industries.

Senator Cook: One would be getting the bonus which would be taken from the other.

Senator Phillips (Rigaud): Mr. Gilmour, would you not regard the difficulty of obtaining oil markets as bearing on the distinction that is being drawn? You have used the expression "when the oil companies decide to put wells into production, they will then produce a profit". Is there not a problem inherent in the industry involving the attaining of markets before putting the wells into production?

The Chairman: I suppose both markets and allowables.

Senator Phillips (Rigaud): I meant by that, Mr. Chairman, the allowables that would create the market. I am just drawing a fundamental distinction that should be on the record.

Senator Beaubien: Mr. Gilmour, do the provinces levy a tax on oil the same as they do on minerals?

Mr. Gilmour: Yes. There are provincial taxes.

Senator Beaubien: Do they have a royalty, too?

Mr. Gilmour: Yes.

The Chairman: May I refer the senators to paragraph 5.24 in the White Paper? Certainly, you will find there sufficient acknowledgement as to the importance of the contributions of the mining industry. May I read it? It says:

> 5.24 The government has concluded that special rules are still needed for the mineral industry, but that they should be revised substantially to ensure that really profitable projects bear a fair share of the burden of taxation.

This is what is supposed to be behind these proposed changes in the law and the rules governing the taxation of mines. Their idea is that there should be some formula to say when they are profitable and at that stage there should be taxation. Now they go on to say:

> It is recognized that the exploration for and development of mines and oil and gas deposits involve more than the usual industrial risks and the scale of these risks is quite uncertain in most cases. Consequently, special arrangements are desirable to ensure that the costs of exploration and development may be charged for tax purposes as early as possible in order that taxes will only be applied when it is clear that a project will be profitable. Secondly, it is recognized that the exploration for and development of mineral deposits continue to provide special benefits to Canada and to various provinces by creating or maintaining highly productive industry in areas other than those where rapid urban and industrial growth are already occurring as a result of both private and public efforts.

They continue on, and at the end they come to this conclusion:

> It is believed that support on a less-generous scale should suffice for this purpose.

Now, some of the factors that are not mentioned here are such factors as, for instance, the earning of foreign exchange, which I am sure in relation to our production and export of minerals is a very substantial item. Would you agree with that, Mr. Powis?

Mr. Powis: Yes, sir, I certainly would.

The Chairman: And the attraction and the inflow of foreign capital to Canada, which provides for this expansion and increases the purchasing power of the people domestically, and which also provides for the establishment of what you might call secondary undustries, necessary in connection with the development and production of mineral properties. Is that a fair assessment?

Mr. Powis: Yes, sir.

Senator Macnaughton: Mr. Chairman, on page 2 of the brief, item 3 is "the effect of the Proposals on exploration of new mines in Canada." That item is very well detailed on page 4. May I just refer to one or two phrases there? In the third paragraph on page 4 there is this statement:

> Canadian ore reserves in relation to production are low in comparison with those of other nations.

In paragraph 5 there is reference to a study, the conclusion of which is that the implementation of the Carter Commission proposals would reduce the value of an aver-

age mineral discovery by 40 per cent. The writers of the brief say that:

> "we believe this to be a minimal estimate and the drop could be much more severe under either Carter or the proposed system."

Further on it says:

> Foreign companies, however, would almost certainly find Canada a considerably less desirable area for exploration.

Then, almost at the conclusion, it says:

> The effect of tax uncertainties has already slowed down the growth of the industry, as indicated by the fact that mining is the only major industrial sector with declining investment expectations in 1970, for the second year in a row.

And then the last sentence is:

> The ultimate effect, nevertheless, would be drastic and adverse for Canada.

All of this adds up to economic impact of the White Paper proposals, I assume. Now, I am not trying to be smart, but I am just trying to draw you out further on this section when I ask you this question: is it possible that the authors of the White Paper (a) did not know of these effects, or (b), do not care about these effects, or (c), is your case slightly exaggerated?

Mr. Powis: We do not believe the case is exaggerated, sir. In fact, the study referred to was commissioned by the Department of Finance, and, I think, was conducted by one of the authors of the Carter Commission report. They concluded that there would be a drop in exploration of 40 per cent because the value of mineral discovery would drop by 40 per cent. I question the correlation. If the value of mineral discovery is 40 per cent lower, then there is the real question as to whether the drop might not be 50 or 60 per cent in exploration, because there are other attractive areas in the world in which you can find mines. We do not believe we have exaggerated the case at all.

As for the motivation of the drafters of these proposals, I can only conclude that one of two things is true. One, that they underestimate the impact of these proposals would have on exploration; or, two, that they do not care about the mining industry. The Carter Commission did make the statement that these tax incentives resulted in misallocation of resources and that too much capital was flowing into mining and not enough into secondary industry.

Our answer is that if capital does not flow into mining in Canada, it is going to flow into mining somewhere else, and it is certainly not going to flow into secondary industry. Secondly, the mining industry in Canada has created secondary industry, as we can demonstrate in our case where we created companies to manufacture the metal products we produce.

The Chairman: You created a plant up in the Elliott Lake area for the production of sulphuric acid.

Mr. Powis: Yes.

The Chairman: In connection with the development of the uranium property.

Mr. Powis: Yes. In fact, in Canada we operate a total of 14 plants in seven provinces which manufacture into wire, cable, tube, strip and a variety of other products. So this is a case where mining has created secondary industry and has not diverted capital away from it. But it is idle to suppose that because a company like Noranda or International Nickel Company is being discouraged from developing mines they are going to turn around and put money into producing nylon stockings. They are going to look for mines somewhere else.

Senator Beaubien: They are!

Mr. Powis: Yes. In our own case we felt it essential, during this period when we have been labouring under considerable uncertainty regarding the future of mining in Canada, as a conscious matter of policy we have built up our exploration staff and capabilities in other areas of the world, with particular emphasis on the United States and Australia—also some in Mexico and various other Latin American countries; but we feel we have to do this in terms of the future of Noranda, because if the climate for the development of mines in this country is going to deteriorate, we do not intend to get out of the business but we intend to put our capital somewhere else.

Senator Macnaughton: That is a reference to the reduction from 80 to 50 per cent?

Mr. Powis: Yes.

Senator Molson: May I leave the White Paper and the brief for a moment to ask a

question that affects their industry, Mr. Chairman?

The Chairman: Yes.

Senator Molson: With the very rapid development of methods of dealing with pollution, is this not going to have quite a substantial economic effect on your industry and on your company? Will you not be called upon to find quite substantial sums of money in your various operations in order to co-operate in the necessity of eliminating pollution?

Mr. Powis: Yes, we will. In fact, we have been spending money on this for a number of years. In a mining operation there are two principal sources of pollution. One is tailings out of your mill. We and many others have been doing a great deal of work on growing grass and other things in order to restore the countryside. The second source of pollution in smelting operations is the emission of sulphur dioxide gas. Most ores are sulphide ores and this has to be burned off in the process of smelting. In this case we have spent a great deal of money at Noranda on a pilot plant on a new process to smelt copper ores which, if we are successful, will eliminate this problem.

However, there is before the industry a fairly massive expenditure on this sort of thing, but it is not as if we are just starting on it, but with growing public sentiment in terms of pollution, certainly we are going to have to do a lot more.

The Chairman: Following what you asked, Senator Molson: Looking at the docket, the second last page, where calculation is made on mining companies and the effect of the White Paper proposals on the money that is available, I notice, Mr. Powis, if you would look at it, that you have certain headings of expenditure, exploration and development and capital expenditure, and then dividends to outside shareholders. Would I be reasonable in assuming that expenditures on exploration and development and capital expenditures might be reasonably constant, or that there might be items—for instance, that you find in connection with pollution—that would come along and might require the same total amount of money you now show annually required to deal with all exploration and development and capital expenditure?

Mr. Powis: We try to keep them relatively constant. Sometimes we have great surges in capital expenditure, but I would say that as a general rule—although this year we have to cut back because there is no way to borrow money—the expenditures are on a rising trend, if not constant.

The Chairman: But if the White Paper proposals mean that you will be paying more taxes, then the only place left for you to cut back is in the amount that is available for dividends.

Mr. Powis: That is right.

Senator Molson: Will not that alter the value of the stock, Mr. Chairman?

Mr. Powis: I would hate to go back and see the stock has dropped by 10 points!

Senator Phillips (Rigaud): Let us assume for the moment that you are sick and we are providing a medical prescription, and we get to page 7 where you made some suggestions. The first one deals with exempt income, and I have two or three questions to put to you so that this committee can get some idea as to what the nature of the relief would be if there was a remedy.

My first question is, with respect to exempt income and your suggestion it be applied to three years or the recovery of initial capital, is there a precedent for a conception of exempt income being related to recovery of the capital in any given country?

Mr. Powis: I do not think so.

Senator Phillips (Rigaud): So, if this committee were to suggest that and accept your suggestion, we would be entering virgin soil?

Mr. Powis: Yes.

Senator Phillips (Rigaud): It is a new thought?

Mr. Powis: Yes.

Mr. Zimmerman: There has been similar treatment under the depressed area legislation in Canada.

Senator Phillips (Rigaud): I am glad you are introducing that into the record. Will you say that again, please?

Mr. Zimmerman: There has been a similar provision in the legislation in respect of depressed areas in Canada.

Senator Phillips (Rigaud): You are referring to areas of regional disparity?

Mr. Zimmerman: Yes.

Senator Phillips (Rigaud): So overall in Government activity we do have some sort of precedent for considering the concept?

Mr. Zimmerman: Yes, sir.

Senator Phillips (Rigaud): Although it is not related to the mining industry as such, or our present tax legislation?

Mr. Zimmerman: That is right.

Senator Phillips (Rigaud): My second question is with respect to depletion. Personally, I have been very much interested in your concept that this $1 for $3 formula be extended to include existing operations. My question is: If you were to make a choice between the improvement of a $1 for $3 formula, or the acceptance thereof to include expenditures on existing operations, which would give you more relief, broadly speaking? I know that you would prefer both, but . .

Mr. Zimmerman: I think that that is impossible to answer. It is mathematics, depending upon—if you had spent all of your capital and never had any cause to spend more, then...

Senator Phillips (Rigaud): Suppose I have the two in my hands—the $1 for $3, or the $2 for $3, as against...

The Chairman: Or $1 for $1.

Senator Phillips (Rigaud): Yes—the extension of your existing operations. Which hand would you choose? I just want to obtain some idea of which one appeals to you most?

Mr. Zimmerman: I do not think it is a question we can answer properly.

Mr. Powis: There is not a simple answer, sir, because what might be true for one mining operation would not be true for another.

Senator Phillips (Rigaud): I am asking the question with respect to your mining operation.

Mr. Zimmerman: You have to take into account the fact that there are all these different companies. If you were speaking of one company that was fully developed then I think we would take the $1 for $1.

Senator Phillips (Rigaud): You would prefer the $1 for $1. I will put the question in a different way. Would you regard relief for an existing operation to be within the meaning of the subject matter discussed by you as giving you significant relief?

Mr. Powis: Would you repeat that question, please?

Senator Phillips (Rigaud): If you were allowed to extend the formula proposed in the White Paper to existing operations, would such extension give you significant relief?

Mr. Powis: Yes, sir, it would, provided also that the provision at the bottom of page 7 were also put into effect—in other words, avoiding the retroactive impact of this.

To give you an example I will mention that we have just completed the development of a $90 million potash mine in Saskatchewan. None of those expenditures are going to qualify for the earning of depletion because they have been undertaken prior to November 7th.

Senator Phillips (Rigaud): I do not want to go into the retroactive aspect for the moment. I am asking you the basic question: Would the extension to existing operations give you substantial relief?

Mr. Powis: It would give us substantial relief, but I do not think it would solve the problem.

Senator Phillips (Rigaud): I understand. We are dealing in terms of suggestions, and considering what recommendations we can make without completely emasculating the White Paper. I am wondering whether the relief that we might suggest would have any significance. If it has not then there is no point in this exercise.

Mr. Powis: Yes, sir, it would have significance.

Senator Phillips (Rigaud): The third question that I would put to you is with respect to the mining tax credit. At the top of page 8 you say that you believe that provincial mining taxes should be credited against income taxes rather than merely deducted as an expense. Would that give you substantial relief? If the provincial mining taxes were so credited would the relief be illusory, or would it be significant?

Mr. Zimmerman: It would give consistency, which we do not have now.

Mr. Powis: We cite the example of Gaspé Copper Mines Limited which would be paying

a 55 per cent tax under these proposals. If we were able to credit the amount of provincial tax against the federal income tax and so bring the rate down to 50 per cent, then obviously we would benefit from that 5 per cent, but whether it is a real benefit or an illusion depends upon corporate dividends, and dividends to shareholders, because if they give that relief and then turn around and tax it in the hands of Noranda when Gaspé Copper gives us a dividend then it is an illusion, or if they take it away when it is in the hands of our shareholders it is an illusion.

Senator Phillips (Rigaud): That brings me to my last question. I am very much impressed, as I am sure are all the members of this committee, by the ramifications of your operations as reflected in Exhibit C. In the old days we had consolidated tax returns but, of course, they are not allowed today. If in the proposed new legislation the concept of consolidated tax returns were re-introduced applicable (a) to wholly-owned subsidiaries, and (b) to controlled subsidiaries, would that bring you or your shareholders substantial relief?

Mr. Powis: It would bring relief to Noranda itself, but not necessarily to the shareholders unless these other provisions were enacted.

If you look at that chart you will see that there is a number of important companies in the green section. Placer Development Limited is a large mining development company centred in Vancouver. We could not file a consolidated return with Placer Development Limited. We would get murdered when they paid us dividends. A consolidated tax return would not provide us relief in the case of Craigmont Mines Limited or Mattagami Lake Mines Limited, and so forth. These are important operations that contribute significantly to the $17 million of investment income that we show. A consolidated tax return would not assist us in those cases.

As we point out in our brief, we do not know what we should do with our investments in those companies if the proposals are adopted. We would either have to merge with them or sell them.

Senator Phillips (Rigaud): I would like to ask Mr. Gilmour whether it is worth while pursuing the thought that the company be asked to develop something on this question of whether the re-introduction of a consolidated tax return with respect to wholly-owned and controlled subsidiaries would have a significant effect.

The Chairman: I think it is something that we should discuss, and perhaps we should ask the company to follow up what you have said, Senator Phillips. It would appear to me that any changes that we propose along the line of the questions you have been putting to the witnesses, which would have the effect of providing some direct retention of more of the earnings in the company, would not necessarily, if other features of the White Paper continue to exist, produce much, if any benefit to Noranda. Is that not right, Mr. Powis?

Mr. Powis: That is right.

The Chairman: So we have to look at the question in a larger area. One point of it concerns the particular applications in relation to the mining industry, and you develop this in your brief. I for one would like to see the questions that Senator Phillips has put followed up in a special study, which would also set out the ramifications. If these changes which would produce these beneficial results are made then I would like to know what is the effect, or whether the beneficial results are just an illusion. I should also like to know what is the effect of other portions of the White Paper on the situation in which more money is left in the hands of Noranda.

Senator Hays: We have had placed before us a pretty grim picture of what will happen to the mining industry if the proposals in the White Paper become law. I am wondering what the thinking of Noranda is about the situation that will evolve if effect is given to the proposals in the White Paper. You told us that in most of the countries where you have subsidiaries you pay hardly any tax at all. Canada imposes the highest taxes of any country. I have been informed by many oil companies, who I thought were not serious, that if indeed what is proposed becomes law they are leaving Canada. I now believe that these people are very serious. What would be your position, as President of Noranda, and your future investments? Or, indeed, why have you stayed as long as you have?

Mr. Powis: We are in Canada because we are a Canadian company, we are Canadian owned, Canadian managed, and it is very difficult for a Canadian company to extract

itself from Canada. Maybe, Standard Oil of California can but we cannot. As for the course we would pursue in future, the sensible thing for us to do if these White Paper rules are enacted is, first of all, as I think we have indicated in the brief, we must find a substantial source of foreign income, preferably American income, against which we can write off the expenses of our exploration activity in various parts of the world. Seconly, our exploration activities should be diverted more than they have been to date to other parts of the world. Thirdly, I suppose over a period of time our income is very much more heavily weighted from other parts of the world. This, of course, creates a problem, to which we have alluded in the brief, in terms of the foreign source income. I think in the circumstances what we do is, we do not remit our foreign source income to Canada but rather use that as an accumulation of capital outside of Canada to finance projects as they come along, and use our Canadian source income for dividends. How long you can keep on that sort of treadmill I do not know. Maybe over a period of years the tax laws will change back in our favour.

Senator Hays: At the moment your thinking is that you will be looking outside of Canada?

Mr. Powis: Yes, sir, we have to.

Senator Hays: Under the proposals of this White Paper, as I understand it, if they became law you would not be interested in financing in Canada?

Mr. Powis: The rate of return would not be adequate to attract the investment, that is right.

Senator Cook: Would you try to buy an outside source of income?

Mr. Powis: Yes, sir.

Senator Cook: Would you buy an existing company?

Mr. Powis: If we cannot do otherwise we will buy it. As a matter of fact, in New Mexico we had a uranium mine prospect which may provide a substantial amount of foreign source income for us.

Senator Lang: You have engineers and other skilled personnel who are Canadians employed in operations abroad?

Mr. Powis: Yes, sir.

Senator Lang: Do you think the Canadian tax structure as contemplated will have any effect on their wishes in respect of residence?

Mr. Powis: The Canadian tax structure as it presently exists is such that if we move an employee from Canada to the United States we confer a very substantial benefit on him even if we do not move his salary up, because United States taxes are distinctly lower than Canadian taxes right now for the type of person we are talking about. Under the White Paper rules it will be worse. The problem is not to move people to the United States, but how to compensate them financially for moving them back to Canada if you want them here again. I believe Mr. Zimmerman has some figures on this.

Mr. Zimmerman: For a man earning $21,000 a year, the Canadian tax rate in 1969 effective would be 23 per cent; in the United States 15 per cent. In 1975 the Canadian tax rate would be 26 per cent; in the United States, 13 per cent. We worked out a very detailed example and assumed the man had a certain amount of investment income, mortgage payments, municipal taxes and these sorts of things.

The Chairman: About twice as much.

Mr. Zimmerman: It gets to be twice as much.

Senator Hays: Do you not think you have an obligation to your shareholders to invest outside of Canada?

Mr. Powis: Yes, sir. This is why we have done what we have done. In our view, because of the incentives that have existed over the past few years it has been only prudent in terms of our shareholders to establish operating bases in other parts of the world. To date we are uncertain; we have been diverting expenditures in order to build up capabilities in other parts of the world so that we can shift the emphasis very quickly if we have to.

Senator Hays: Do you feel that any tax law changes should not be made as quickly as they have been in Canada, but there should be at least a five-year or six-year basis, or move into it gradually over an even longer period, say ten years?

The Chairman: That is only deferring the problem, is it not?

Senator Hays: I know, but sometimes it gives government an opportunity to see what the effect will be before making proposals law.

Mr. Zimmerman: In simple terms, in the case we have given of Gaspé Copper, the proposals reduce the incentive by 80 per cent and increase taxes by 35 per cent. If you were an individual I do not think the government would make such a change to increase the tax rate 35 per cent.

Mr. Powis: In terms of the transitional period, quite obviously the drafters of the White Paper recognized that this is a fairly traumatic thing to the mining industry, and I can think of no other reason why they would provide a five-year transition period.

Senator Hays: How many shareholders do you have in Canada?

Mr. Powis: About 32,000.

Senator Hays: So these people will be affected.

Mr. Powis: Yes.

Senator Molson: How substantial a stake in the holding has Hollinger got?

Mr. Powis: Hollinger holds about 12 per cent of our shares.

Senator Connolly (Ottawa West): Did you make such a thorough examination of the problems of your company before the Carter Commission as you have here this morning?

Mr. Powis: No, sir.

Mr. Zimmerman: We did not appear before the Carter Commission as a company. The industry did. However, we did make a submission following the Carter Commission Report, which is attached here as an appendix, and we had no questioning whatever on that brief.

Senator Carter: I do not know whether this question should be put to the witnesses or to Mr. Gilmour. I am referring to the last page of the docket where we see the earnings of Noranda. For 1965 to 1968, the increase of the proposed tax over the present tax system is roughly of the order of about 50 per cent. In the year 1967 it is nearly 100 per cent. What factor produced that wide discrepancy? What factor obtained in 1967 that does not obtain in the other three years to produce that wide fluctuation for 1967?

Mr. Powis: I think we had a very large capital gain, sir.

Senator Carter: This does not show up in the tables I have, because in the comparisons there they are very much the same.

Mr. Powis: When we talked about pre-tax or taxable income, this was a capital gain of some $26 million on the sale of stock in Denison Mines, and this was credited directly to our surplus. It was not reflected in the earnings at all. Under the White Paper proposals, we would pay a tax on that again and that is what inflates the 1967 figure.

Senator Carter: Coming to Exhibit B, a graph down there for the oil shows hardly any difference between the present system and the proposed system. The broken line and solid line are pretty much the same, and yet my understanding is that the oil companies themselves are not very happy with the proposed taxation.

Mr. Powis: Well, I think that the oil companies are probably looking some distance ahead. We don't believe that in the years noted, 1960 to 1966, under these proposals the oil companies would have paid any more taxes. All of the increase in tax revenue would have come from the mining industry.

I think the oil companies will have to answer themselves as to why they are unhappy with the proposals.

Senator Carter: Are you saying that these two lines coincide only co-incidentally within that period? And that prior to 1960 they would diverge and beyond 1966 they would also diverge?

Mr. Powis: I don't think they would diverge prior to '60. I don't think they would diverge right now, although we have no statistics to back that up. The divergence, when it takes place, will take place at a time when the pace of exploration activity in Canada and the cost of acquisition of land so forth taper off and they start, if you like, to go into production. So long as Canada's oil reserves keep on increasing at the rate they are and so long as the level of expenditure on the oil exploration increases the way it is, I don't think the oil industry is particularly affected by these proposals. If and when all the oil is found and things taper off, then they will start to get hit, I believe.

Senator Carter: Did I understand you to say earlier than when you pay provincial tax it is really a cost of production?

Mr. Powis: No, sir. We don't regard it as a cost of production any more than we regard federal income tax as a cost of production. They are taxes on income and they are levied by the government, irrespective of who owns the mineral rights. For example, Texas Gulf was found on land that was not crown land but they still pay the provincial mining taxes.

The Chairman: What he is saying, Senator Carter, is that provincial mining tax should be deductible from the federal tax rather than simply be an expense of doing business.

Mr. Powis: The way they are presently treated is that we pay provincial mining taxes and then we pay federal taxes on the residual income. In other words, the federal Government allows them as expenses not as a deduction.

Senator Carter: I see.

The Chairman: Are there any other questions?

Senator Molson: The provincial tax is based on the mine head prices, is it?

The Chairman: It is based on the value of the ore at the pithead, but I am sure they have a good look at what the income realized from the sale of the ore is.

Senator Everett: Mr. Chairman, dealing with Senator Phillips' (Rigaud): interesting suggestion regarding the consolidated return, and dealing specifically with the shareholder problems and problems of getting creditable tax, do you see that suggestion, while it is a benefit to the company, as being of any benefit to the shareholder?

Mr. Powis: It is a benefit to the shareholder only in the sense that we would report earnings somewhat higher than otherwise. However, ultimately, the benefit to the shareholder is the money he gets out of the company and under this gross-up provision it would not benefit him. In order to be anything more than an illusion it would have to be coupled with some modification in the rules relating to tax on dividends in the hands of individual shareholders.

Senator Everett: That would suggest that the only way in which the shareholder could be benefitted is by taking up your suggestion that it should be assumed that the corporation has paid the full taxes whether it has or not.

Mr. Powis: Yes.

Senator Macnaughton: Mr. Chairman, the witness did mention the potash investment out west, but I did not quite get the details of that. I understand that the company went in on a certain basis and, if the rules were now changed, there would be certain effects. Could you just explain that quickly, please?

Mr. Powis: Well, sir, when we went into the potash venture we started work on it in 1966, before we were even aware of the content of the Carter Commission proposals. One of the basic problems with the potash project is that the expenditures were largely completed toward the end of last year. So we spent $90 million on the development of that mine, but that mine will have no depletion after 1975 because all of those $90 million spent developing it are not eligible to earn depletion after 1975. So in 1976 that mine will be taxed at a rate of 50 plus per cent. In working out the economics of the operation we counted on the tax-free period which we will get, but what was very much more important in terms of the economics of it was the continuing depletion allowance. After 1975, under these proposals, there would be no depletion allowance and the difference in the tax bill that we will have to pay is sufficient to bring the rate of return to a level which just would not meet any standard of investment at all.

Senator Lang: What would be the level of profit?

Mr. Powis: Well, I think we went into that to some extent in our brief. If you put it on the basis of the assumptions that we made in placing the mine into production, there was a present value of discounted cash flow from the operation. It had a present value of about $120 million at 10 per cent discounted cash flow rate. This 10 per cent is just not an adequate rate of return, but, if you discounted the expected cash flow, it had a present value of $120 million as opposed to the $90 million expenditure required to place it in production.

Mr. Zimmerman: Including depletion.

Mr. Powis: This was on the basis of the old rules. The present value under the new rules would be reduced to something in the order

of $90 million, which is exactly equal to the expenditure required to place it in production. Ten per cent is simply not enough in today's world. So it is just not attractive enough in those circumstances to merit putting $90 million of our money into it.

The Chairman: But you already have.

Mr. Powis: We have already. We started out on the basis we would be living under the rules that existed in 1966. We made commitments with consumers of the product, but having started in 1966 we could not turn back. Had we known we were going to be faced with this, we would not have done it. I still do not know that we are going to be faced with it.

Senator Phillips (Rigaud): On the last page, which deals with your expenditures on exploration and capital expenditures and dividends paid to shareholders, under the White Paper and assuming the expenditures to continue on the same relative basis, would you have cash flow problems with relation to funded debt? In other words, would you be tight on money to meet your obligations if you still serviced your shareholders?

Mr. Powis: It becomes a real question as to whether you cut down...

Senator Phillips (Rigaud): Assuming that you are not cutting down but are maintaining the same standard of exploration expenditure, capital expenditure and serving your equity shareholders.

Mr. Powis: Under present money conditions we have a real problem because money from the bond market has almost disappeared. The only basis on which we can raise capital is with a bond issue of some description. They are all extremely expensive and require for reinvestment a rate of return very much higher than heretofore has been required. A combination of the tax proposals and the money market creates a real problem.

The Chairman: Are there any other questions or shall we adjourn?

I thank Mr. Powis, Mr. Zimmerman and the others for the presentation they have made and the information they have given.

We will be sitting next Wednesday morning at.

Senator Molson: 9.30?

The Chairman: No, at 9 a.m.

The committee adjourned.

APPENDIX A

noranda
MINES LIMITED

submission to

THE STANDING COMMITTEE
ON BANKING, TRADE & COMMERCE

studying

PROPOSALS FOR TAX REFORM

Ottawa, Ontario
January 29, 1970

This brief on behalf of Noranda Mines Limited has been prepared in a shorter time than the Company would have preferred. In the period since November 7, it has simply not been possible for anyone to gain a complete understanding of the implications of such a drastically new system, produced after years of research. Accordingly any general conclusions at this point must be tentative in nature. While we have grave concern about the overall impact of the proposed new system, this brief will focus on the particular problems we believe it would create for Noranda and the mining industry in general.

If, during the discussion of this brief or our continuing research, further problems come to our attention, we respectfully request the opportunity to submit a supplement.

Noranda's concern with the Proposals falls into three general areas:

1) **Recognition has been given to the special risks inherent in mining and the need for special tax treatment. Nevertheless, it is proposed that the present incentives be removed and replaced by provisions which would substantially increase the tax burden for the industry. Mature Canadian mines without earned depletion would pay higher taxes on income than any other segment of the economy, and considerably higher taxes than in such countries as the United States and Australia. From the standpoint of Canadian shareholders of a mining company, such incentives as are proposed are a complete illusion. The reduction in potential returns on capital employed by both the companies and their shareholders would reduce the value of mineral discoveries and thus the level of exploration which is vital to the future of the industry in Canada. Particularly for foreign companies, the real incentive would be to divert exploration out of Canada.**
2) **It is proposed that the income relationships between a widely held Canadian company such as Noranda and its subsidiaries and associates, domestic and foreign, be completely altered. For a company such as Noranda, this would require a radical change in our corporate structure and the way in which we do business. These proposed changes more than any others seem to be motivated by a desire for symmetry rather than by revenue or equity considerations, and there seems to be no justification for forcing such a profound alteration in the structure of the mining industry (and many others).**
3) **The entire thrust of the Proposals favours consumption, rather than saving, by individuals and the payment of dividends, rather than reinvestment of earnings, by corporations. There is no way it can be proven but we are concerned that those who drafted the Proposals have seriously underestimated the psychological impact the new system would have on the desire of Canadians to accumulate capital. While the Proposals appear to contain a bias in favour of ownership of Canadian industry by Canadians, the opposite would happen if our concern proves correct, to say nothing of the impact on future growth and living standards.**

By way of background, attached are two appendices: Noranda's presentation to the Minister of Finance following the Carter Commission report and a paper entitled "Mining Tax Incentives". The latter, prepared by J. D. Gibson with some professional mining assistance, outlines the record of the industry in the Canadian economy noting especially:

1) **A tenfold increase in the value of mineral production since the end of the war to $4½ billion per annum.**
2) **The largest single contribution to better regional economic balance in Canada.**
3) **An increase in productivity notably higher than in the rest of the economy.**
4) **A massive increase in exports.**

In its own submission Noranda made reference to the fact that it had spent its tax benefits on exploration, the return to shareholders had been reasonable but not excessive, its resources had been devoted to Canadian development, and in the five year period 1962 - 1966 its effective mining and income tax rate had been 48.8%. The Committee's attention is directed particularly to sections III and V of Appendix II which deal with the nature of the special problems in the mining industry and one company's record in dealing with these.

It is understood that the Government's objective is a tax system which will:

a) Create a comprehensive tax base.

b) Shift the burden of taxes away from lower income groups, by increasing the tax on those better able to pay.

c) Not impede growth and prosperity in the Canadian economy.

Noranda is in general agreement with these objectives, but believes they are incompatible with many of the Proposals. Noranda's knowledge and expertise is primarily in mining and related fields. While we believe that goals (a) and (b) could just as well be achieved by amendments to the present system, we intend to leave this discussion to others and concentrate on those Proposals where we have direct knowledge.

Accordingly, this brief deals with four major points:

1) The distinction between the oil and mining industries.

2) The impact of the Proposals on a typical mature and integrated Canadian mining company.

3) The effect of the Proposals on exploration of new mines in Canada.

4) The effect of the Proposals on the corporate structure and business practices of Noranda.

The Distinction Between the Oil and Mining Industries

It is the mining industry's great misfortune to have been grouped with the oil and gas industry in the Proposals under the category of "Operators of Mineral Resources". In fact, the two industries are completely different and there would be as much logic in grouping automobiles with beer because they are both sold to consumers.

Apparently equal treatment is proposed for the two industries, but the overall impact on the mining industry would be very considerably more severe than in the case of oil and gas for two reasons:

1) It is proposed that the mining industry lose the three year period of tax exemption, which never applied to oil and gas.

2) It is proposed that each industry earn depletion in the same manner, although the structure of the two industries is such that the depletion could be earned very much more easily by the oil and gas producers than by mines.

The basis of the depletion allowances proposed is that they be earned by investment in new plant, exploration and development, for which \$3 must be spent for each \$1 of depletion credit allowed. New plant for this purpose would apparently not include extension or replacement of existing operations. This compares with present regulations under which depletion is simply one-third of taxable mineral income.

It will be seen from the attached Exhibit A that, although the expenditures of both industries are approximately the same, the oil industry spends three to five times as much on exploration and development. Because the Proposals do not include capital expenditures on existing plant in the depletion base, the capital expenditures shown for mining companies (which include substantial plant additions or replacement and mine development) would be much reduced for depletion base purposes. Accordingly, allowable depletion for mines would be small indeed.

Exhibit B shows present depletion compared with taxes payable for both industries as well as what is proposed. The result is fairly obvious — that any increase in tax revenues from the existing mineral industries would come entirely from the mining companies.

If the principle of earned depletion is accepted, then it is completely illogical to exclude capital expenditures incurred after a new mine has reached production. These are very often expenditures which would have been made at the outset had all the facts about the orebody, markets, technology or changing government regulations been known. In other cases, these are expenditures which would have been made as part of the original project but are deferred in order to keep down the initial capital requirement.

In any case, the relatively unimportant depletion incentive which would remain under the Proposals is an illusion, as explained later, since essentially it would be taxed away in the hands of the shareholder.

The Effect of the Proposals on Gaspé Copper Mines

Gaspé Copper Mines Ltd. is chosen as an example of the impact of the Proposals on a typical mature mining company as it is similar in nature to the type of copper mining operation commonly being developed — large

tonnage, low grade orebodies being mined by open pit methods. Examples are the Tyrone mine in the U.S., the Peko mine in Australia or the Northgate mine in Ireland.

Located in the heart of the Gaspé Peninsula where it is the major industry, the mine was first discovered in the 1930's but only brought into production in 1956 at a cost of $42 million. Since coming into production, $21 million have been spent on expansion of the original plant and mine workings and a further $15 million was recently spent to develop a secondary orebody. The smelter treats production from Gaspé's two mines as well as others in Quebec, Newfoundland and New Brunswick.

When it came into production, Gaspé was the lowest grade copper mine operating in Canada, and it endured a number of difficulties and misfortunes. These included difficulty in achieving full production due to untrained local labour, a decline in copper prices of more than 50%, power shortages and a seven month strike.

Today, all these difficulties have been overcome and Gaspé Copper is one of the most efficient and profitable operations in the Noranda group. From a national viewpoint, the operation has also made a significant contribution:

1) It has provided stable employment for 1,200 people directly, and many more indirectly, in one of Canada's most economically depressed areas.

2) It has created a new and modern town in the Gaspé Peninsula.

3) It has established a smelter which treats material which otherwise would have been exported in raw form.

4) It has developed methods for the economic extraction of further difficult and low grade ore, previously considered waste.

5) It has become a substantial contributor to the Provincial and Federal Treasuries.

It seems not to be generally recognized that mining companies are subject to provincial mining taxes as well as federal and provincial income taxes. These taxes are sometimes considered a royalty but they are generally payable irrespective of whether the Crown owns the mineral rights. The federal government has argued that, since they are levied by the provinces, they are none of its concern. However, these mining taxes are taxes on income, they produce revenue to the provinces which the federal government would otherwise have to provide, and are an important factor in appraising the economics of a new mine. When these are taken into account, present overall taxes on mining operations in Canada are comparable to those paid in such countries as the United States and Australia and, in fact, are higher for mature mining operations.

Although Gaspé Copper paid mining taxes from the beginning, no federal income tax was paid for the first seven years of operation, nor would there have been any paid for that period under the new Proposals. While this may seem generous, it is a situation common to other resource enterprises such as pulp and paper where capital costs are very large, or to projects taking advantage of area development programmes.

Taxes paid by Gaspé Copper to date are compared below with the taxes it would have paid had the new Proposals been in effect, and the taxes it would have paid in the U.S., Australia and Ireland:

1956 through 1968	**Actual**	**New Proposals**	**U.S.**	**Australia**	**Ireland**
Profits before taxes (millions)	$95.9	$95.9	$95.9	$95.9	$95.9
Taxes on income	28.4	40.3	24.8	28.9	—
Net profit	$67.5	$55.6	$71.1	$67.0	$95.9
Effective tax rate	29%	42%	26%	30%	—
1968 only					
Profits before taxes	$17.2	$17.2	$17.2	$17.2	$17.2
Taxes on income	7.4	9.5	5.6	6.2	—
Net profit	$ 9.8	$ 7.7	$11.6	$11.0	$17.2
Effective tax rate	43%	55%	32%	36%	—

Under present tax laws, Gaspé Copper to date would have been approximately as profitable in two of the other three countries, but the more mature the mine the heavier the relative Canadian tax load becomes. Adoption of the new Proposals would substantially increase the tax burden, and we are convinced that this would have a profound impact on the incentive to explore for new mines, and thus on the industry's future.

Effect on Exploration

Exploration for new mines is unlike any other form of business activity, in that the odds against success are astronomical. It has been estimated that only one property out of 10,000 staked in Canada ever results in a mine, and few of these are of any substantial size. In Canada, most of the easily accessible outcropping deposits have been found, and discoveries require increasingly sophisticated and expensive exploration methods. In terms of the average cost of finding a new orebody, it is estimated that some $30 million are spent on exploration for each new discovery as opposed to $12 million in Australia, which has not yet been nearly so extensively explored. This by no means is to suggest that we have even begun to scratch the surface in terms of Canada's mineral wealth, but merely to point out that the process is becoming very expensive. It is obvious that our mineral potential will not be realized unless exploration expenditures continue to increase.

The mere conducting of an exploration programme is no guarantee of success, as luck plays an essential part. With an annual budget now of $5 million per year in Canada, Noranda has not made a discovery of consequence in the past 10 years. On the other hand an associate, Mattagami Lake Mines, has apparently made a major discovery near Sturgeon Lake in its second year of a programme involving expenditure of $500,000 per year.

At the same time, exploration is vital to the survival, let alone the growth, of the Canadian mining industry. Canadian ore reserves in relation to production are low in comparison with those of other nations. In fact there is evidence that we are drawing on this country's ore reserves faster than they are being replaced, and increasing exploration activity is essential if the industry is to maintain its contribution to the national economy.

Under the present system there are probably more mines which were begun in high hopes and failed than mines which expanded and prospered. Any new mine augments the nation's mineral reserves, and provides business for secondary industry, wages for a work force, and mining and sales taxes. Surely this is desirable in itself, albeit not so desirable as an operation which will endure and pay income taxes. It is a certainty that these marginal chances would be eliminated under the Proposals and whatever benefit they are to the economy would be lost.

It is not possible to prove that the new tax proposals would reduce substantially the level of Canadian exploration, as the real effect is a matter of opinion and would only become apparent over a period of time. Nevertheless, we are convinced that the effect would be substantial. A study conducted by the Institute of Quantitative Analysis of the University of Toronto for the Department of Finance concluded that implementation of the Carter Commission proposals would reduce the value of an average mineral discovery by 40%. and that the drop in the level of exploration would be of the same order. We believe this to be a minimal estimate and the drop could be much more severe under either Carter or the proposed system.

The level of exploration in Canada would decline because the value of a new deposit would be lower and because companies operating in this country would have less capital available to conduct exploration and develop new discoveries. Activity would certainly not cease entirely in the case of Canadian companies without foreign operations, since they are to some extent locked in by the non-deductibility of expenditures outside Canada and the onerous provisions regarding foreign-source income. Foreign companies, however, would almost certainly find Canada a considerably less desirable area for exploration.

In Noranda's own case, we have been uncertain as to the future tax structure for over 5 years and have felt it necessary to build up our staffs and capabilities in other countries. Whereas 80% of our expenditures 5 years ago were in Canada, our budget for 1970 calls for 50% of our exploration expenditures outside Canada. If the new Proposals are implemented, the proper course for Noranda to follow would be to acquire substantial foreign income against which our expanding efforts outside Canada could be written off for tax purposes.

The effect of tax uncertainties has already slowed down the growth of the industry, as indicated by the fact that mining is the only major industrial sector with declining investment expectations in 1970, for the second year in a row. Given the long lead time between discovery and first production of a new mine, however, a slowdown in exploration now would only really become felt in the latter half of the 1970's. The ultimate effect, nevertheless, would be drastic and adverse for Canada.

Corporate Considerations

The implications of the Proposals in terms of Noranda's corporate structure and methods of doing business are so far-reaching and complex that, despite considerable study, we do not feel we yet completely understand them. We also believe that those who drafted the Proposals could not have intended the results which we think will flow from them.

For a corporation such as Noranda, the problems stem from three sources:

1) The proposed treatment of dividends from other Canadian and foreign companies.

2) The proposed method of calculating taxes payable on dividends received by Noranda shareholders.

3) The principle of earned depletion.

In order to clarify the problem, some background as to the structure of the Noranda group is essential. Exhibit C shows the corporate structure of the Noranda group, with the operating companies divided between those owned 50% or more and normally consolidated, and those owned 25% to 50%. Also shown is the division between closely held and widely held corporations, and between domestic and foreign operations. While at first glance this may appear to be a kind of jungle, it is the natural result of the way our business is carried out and in practice is eminently workable and efficient.

An interest in, or ownership of, a mining operation is acquired in three principal ways —

a) Discovery.

b) Financing the development of orebodies found by others.

c) Open market purchases of established companies.

In many cases the discoverer is incapable of providing the necessary finances or technical talent necessary to develop a mine. The normal practice is then to deal with a company with the necessary resources, and the property is put in a new company in which the discoverer retains a share interest while the developer gets an interest for its role (e.g. Gaspé Copper or Mattagami Lake). Thus each operating mine property tends to be in a separate company. Open market purchases usually leave a substantial outside interest (e.g. Placer or Kerr Addison). Other times, joint ventures are desirable from the outset for reasons of marketing or technical ability (e.g. Central Canada Potash). In still other cases full ownership is achieved either by merger (e.g. Geco Division) or discovery (e.g. Brynnor), with the result that the operation may be carried on in either a division of the company or a closely held subsidiary. There are also instances where a direct interest is held in one company (e.g. Mattagami Lake) and a further interest is acquired indirectly through another company (e.g. Placer).

This method of doing business has worked well and has been entirely feasible under existing tax laws. Under the new Proposals it would be impossible for the following reasons:

1) Depletion would be earned by individual companies and cannot normally be transferred among companies. Thus, one company in the group might have 10 years of earned depletion allowance available while several others were paying taxes at close to 60%.

2) Depletion earned by a subsidiary would largely be taken away in the hands of Noranda when earnings were paid out as dividends, by virtue of the treatment of inter-company dividends.

3) Depletion earned by Noranda would largely be taken away in the hands of its shareholders by virtue of the method of calculating creditable tax. Indeed a low tax rate in any subsidiary or associated company for whatever reason may be of no value to the ultimate shareholder as a result of the 'topping up' process.

To illustrate, the table below shows the impact of the proposals on a mining company (with and without earned depletion) and an industrial company.

	Mining Company		Industrial Company
Tax Calculation	**With depletion**	**Without depletion**	
Income before taxes	$200	$200	$200
Mining tax — 15%	30	30	—
Income Tax	57	85	100
Available for distribution	113	85	100

Tax Calculation	Mining Company With depletion	Mining Company Without depletion	Industrial Company
Payment from Subsidiary			
Available for distribution	$113	$85	$100
Retained by parent	95	85	100
Payment by Parent			
Available for distribution	$113	$85	$100
Retained by shareholder**	71	64	75

** Assumed to be in 50% marginal tax bracket. In the case of a mining company with depletion, this amount would be the same whether the parent or a subsidiary had earned the depletion.

In this example, the mining company would have earned $28 of depletion. By the time the shareholder received the profits as a dividend, however, the net benefit of depletion would have been reduced to $7, or by 75%. In either case, total taxes are greater than would be applicable in other industries.

Under present tax rules, a shareholder of a mining company would retain $86 (compared with the figures of $71 or $64 shown above) under the same circumstances.

Our best guess is that the additional tax impact of the treatment of inter-company dividends on Noranda would average $2 million annually. To avoid this we would have to merge with all of our subsidiary and associated companies. In cases where this proved impossible, and there might well be many, then control of these companies should be sold to foreign interests to whom they would be worth more than they would be to Noranda or anyone else in Canada. The legal and other implications of this to Noranda, and we suspect to others, would be enormous and we fail to see what offsetting gains in terms of equity or revenue would justify this.

From the point of view of Noranda shareholders, however, the ultimate impact could not be avoided. As shown on the previous table, if depletion were not earned, net profits would be substantially less than those of an industrial company with the same profits before taxes. Even if depletion were earned, its benefits would largely be taxed away when received by the shareholder and his net dividend after taxes would be less than if he owned shares of an industrial company with the same pre-tax profits. Thus mining shares would be considerably less attractive to the Canadian public (but not necessarily to foreign interests) than those of companies in other industries, and the industry's ability to raise domestic capital would be seriously impaired. Of course, if its shares became sufficiently depressed in price, Noranda would become ripe for takeover by a foreign company which would not have to live under these Proposals.

Another difficult feature of the Proposals concerns income debentures, which are a common financing method in the mining industry. Income debentures are appropriate because interest is only payable if earned, a considerable advantage in an industry as risky as mining. At the same time, the rate of interest is relatively low since, because the interest has been deemed to be the same as a dividend, it has been received tax free when paid by one corporation to another. (In turn, it has not been deductible as an expense by the paying corporation). As such income would be taxable under the Proposals, this financing method would be effectively destroyed. Noranda's problem is that it presently holds or is obligated to purchase $145 million of such income debentures and would incur an additional tax burden of more than $5 million annually on the interest received on them. We obviously could not allow this to happen and would have to find some way around the problem. The point is, however, that this has been a valuable financing mechanism in our industry and would be destroyed for no real purpose.

Noranda has only recently begun to establish significant operations outside Canada, few of which are yet paying taxes. So far, all of these are in closely held companies which the Proposals would define as "Controlled Foreign Corporations". It appears that, under the Proposals, Canada would generally collect the difference between the rate of tax paid by these companies and our domestic rate of tax, thus eliminating the benefit of lower tax rates or incentives elsewhere. The real effect would be to discourage payment of dividends in Canada from such operations, or elimination of low rates or incentives by the countries involved. Our intention here is simply to record our concern about this problem, as we expect that others more immediately concerned will deal with it exhaustively.

Conclusions

The Proposals claim to recognize the unique nature of the risks inherent in the mining industry and the need for special tax treatment. However, the cumulative impact of the Proposals seems to place mining companies in a worse position than any other significant segment of the economy. Far from permitting further growth, we believe strongly that the special treatment proposed would be inadequate even to permit the mining industry to maintain its present contribution to the national economy, resulting in a net decrease in tax revenues. If it is the policy of the government to reduce the relative importance of mining in Canada, then the Proposals may be an appropriate means to this end but we cannot believe that this is intended.

1) Exempt Income

As has been pointed out, the present Canadian tax system generally produces somewhat higher taxes on mining operations than would apply in other comparable countries, although methods of taxation differ considerably. Mining capital is international in character, and Canada's tax system must be reasonably competitive if our industry is to continue its contribution to the growth of our country.

The present three-year period of tax exemption is an essential part of this system. At the same time, we recognize that in some circumstances it has resulted in enormous windfalls for some mines — due mostly to unusual grade or market conditions — and that these comparatively rare prizes have placed the entire system in disrepute in some circles on grounds of equity.

We suggest that this problem would be solved without destroying the effectiveness of the incentive by simply limiting the present tax exempt provisions to three years or the recovery of initial capital, whichever period is shorter.

2) Depletion

Depletion is the other essential element in the present tax structure as it relates to mining, and is particularly important to mature and long-lived operations. It is a recognized principle in mature mining economies. It is the source of cash flow essential to the maintenance and development of ore reserves, and permits the necessary rate of return on high-risk capital. Finally, it has permitted Canadian operations to match the investment in advanced equipment and technology made possible in competing countries through similar allowances. It follows we would prefer the present system or simple modifications thereto, as it is a foundation of the existing industry.

The concept of earned depletion would cause us severe problems in terms of corporate structure. Moreover we do not understand why the "$1 for $3" ratio was chosen, nor can we understand why expenditures on existing operations were excluded. Although the Proposals give the appearance of maintaining incentives, the result would be (for mining but not for oil) an enormous decrease in the effectiveness of the incentive — over 80% in the case of Noranda — and when provincial mining taxes are included the industry would pay the highest rate of income tax in Canada. Such operations as Central Canada Potash, which was founded on the economics of depletion, cannot earn one cent of depletion under the proposed system.

If the principle of earned depletion were adopted, to provide any meaningful incentive the base should include all expenditures for exploration and development plus fixed assets acquired for the purpose of gaining income from a mine, including such expenditures on existing mining operations. Moreover a $1 for $3 ratio does not provide a meaningful incentive.

The proposed system of earned depletion is further deficient by creating a serious inequity with respect to the arbitrary cut-off date of November 7, 1969 whereby some relatively new operations would not obtain any benefit. To avoid the retroactive impact on the cash flows of committed projects and to achieve equity the following formula would be essential:

1) All mines would calculate the total of expenditures made from the inception of their operations which would have earned depletion had the Proposals been in effect, which would equal the depletion base.
2) From the depletion base would be deducted the total of all unearned depletion claimed up to the end of 1975.
3) A mine would then be entitled to carry forward into 1976 and beyond the difference between (1) and (2) above as earned depletion.

3) Mining Tax Credit

We can agree with the drafters of the Proposals that no individual or corporation should be subject to taxes on income of more than 50%. Therefore, whatever the system finally adopted, to the extent that

a mining company would otherwise pay taxes above 50%, we believe that provincial mining taxes should be credited against income taxes rather than merely deducted as an expense. In cases where production taxes or royalties are substituted for mining taxes — e.g. potash — these should be creditable under similar circumstances. Some limitation on provincial mining taxes creditable — say 15% — would be necessary.

4) Inter-Corporate Dividends

The Proposals concerning taxation of inter-company dividends obviously were devised without consideration of the enormous problems created for such corporate groupings as Noranda. On the assumption that each Canadian company pays taxes appropriate to its circumstances and that double taxes are to be avoided, there is no logic in the concept of creditable tax and recalculation as a dividend moves upward in a chain. Thus the benefits of depletion, accelerated writeoffs, etc. earned by a subsidiary or associate would be largely taxed away in the hands of Noranda. A massive reorganization could help solve the problem, but no useful national purpose would be served.

Inasmuch as no considerations of equity or revenue seem to be involved, we believe that dividends should continue to pass between Canadian corporations free of tax, and existing rules should continue to be maintained respecting income debentures.

We are concerned about the impact of the Proposals on foreign income, but have no particular knowledge in this field. However, it is probable that others more immediately involved than ourselves will have suggestions in this regard.

5) Shareholder Considerations

It would appear that shareholders of mining companies would be particularly hard-hit by the Proposals. Not only would they lose the shareholder depletion heretofore available, but they would also be more heavily taxed on their dividend income than would be the case if they held shares of companies in other industries. If we understand the Proposals, the end result would be to tax away the advantage of any remaining mining incentives in the hands of the Canadian shareholder. The effect on the value of mining shares and on the ability of the industry to raise capital would be serious indeed.

We suggest that the same principle should apply as with dividends between corporations — i.e. that at least so far as domestic income is concerned it should be assumed that a corporation has paid full taxes. This would not only avoid discrimination against the shareholders of companies with tax incentives but would also immensely simplify the calculation of taxes by corporations and their owners.

— — —

These suggestions by Noranda would modify the Proposals sufficiently to maintain a healthy and growing mining industry. We do not believe that they can be faulted on grounds of equity since it is admitted that special tax treatment is needed. On revenue grounds they would have no significant adverse impact, since they would increase taxes from present levels and Chapter 8 of the Proposals includes no allowances for increased revenue from the mining industry. The other suggestions merely rectify what must surely be unintended effects of the Proposals.

We must emphasize that the views expressed are only those of Noranda Mines.

EXHIBIT A

COMPARISON OF CAPITAL EXPENDITURES AND EXPLORATION AND DEVELOPMENT CLAIMS
Mining vs. Petroleum Industries

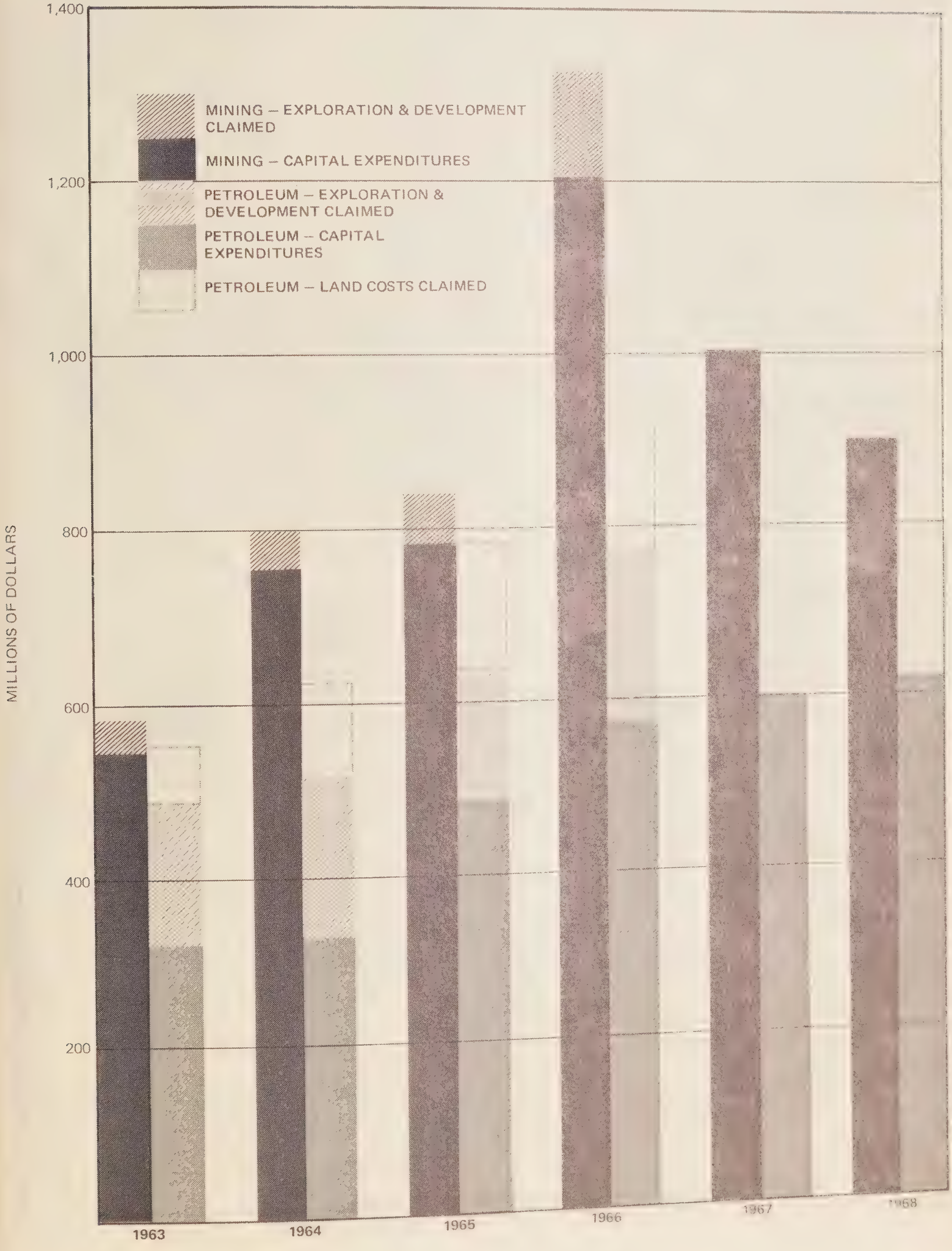
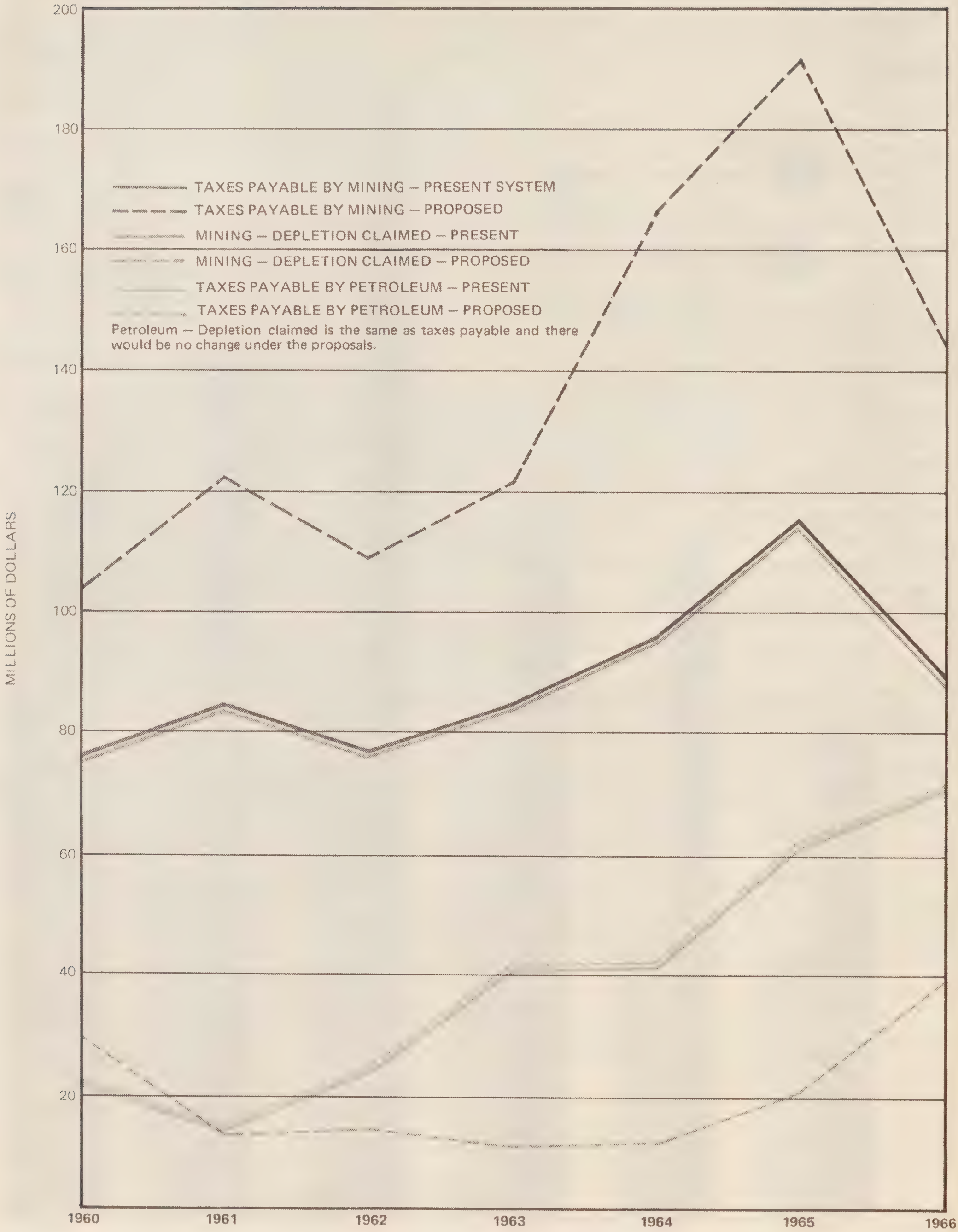


EXHIBIT B

COMPARISON OF INCOME TAXES PAYABLE
MINING VS. PETROLEUM INDUSTRIES



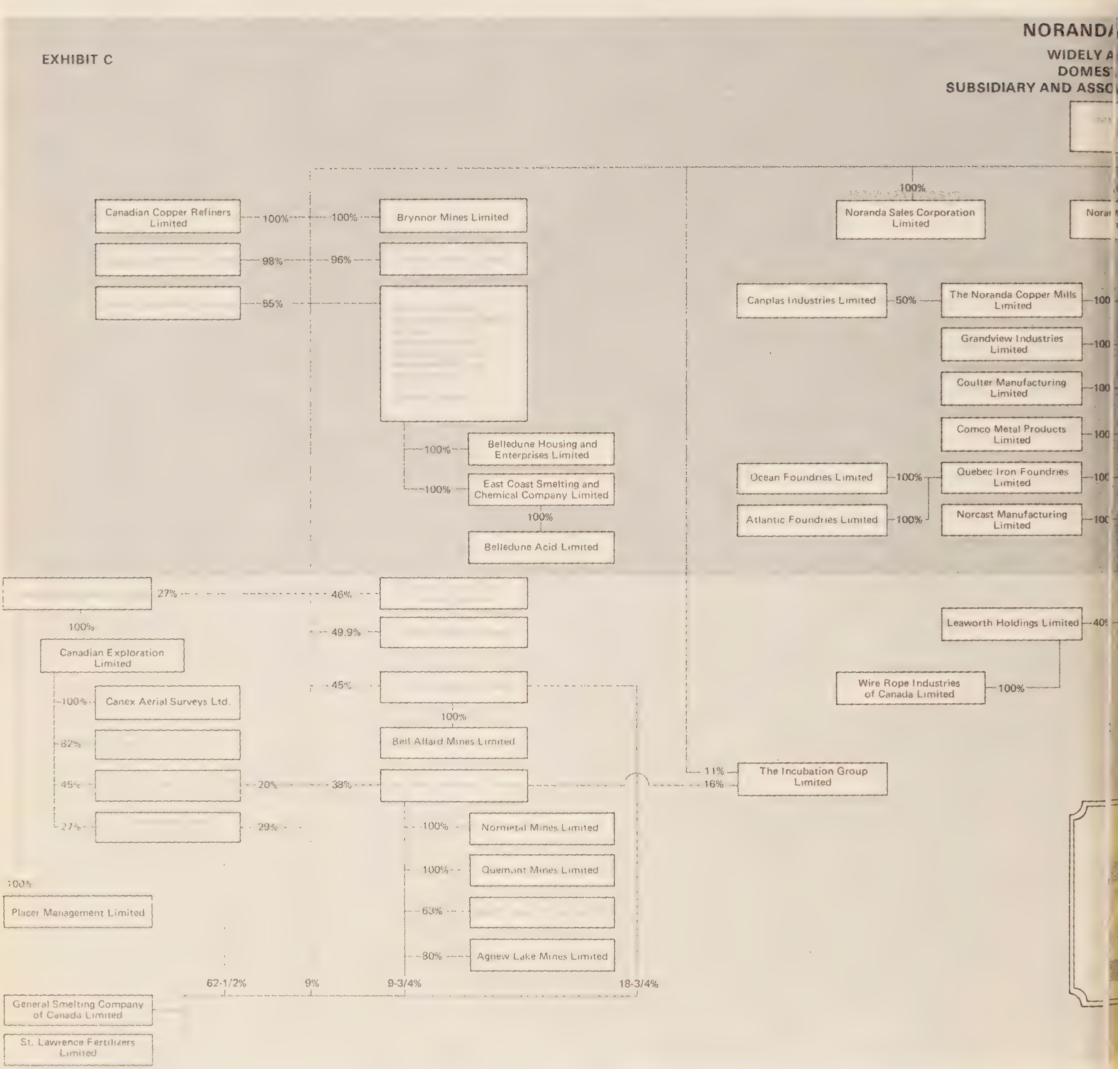
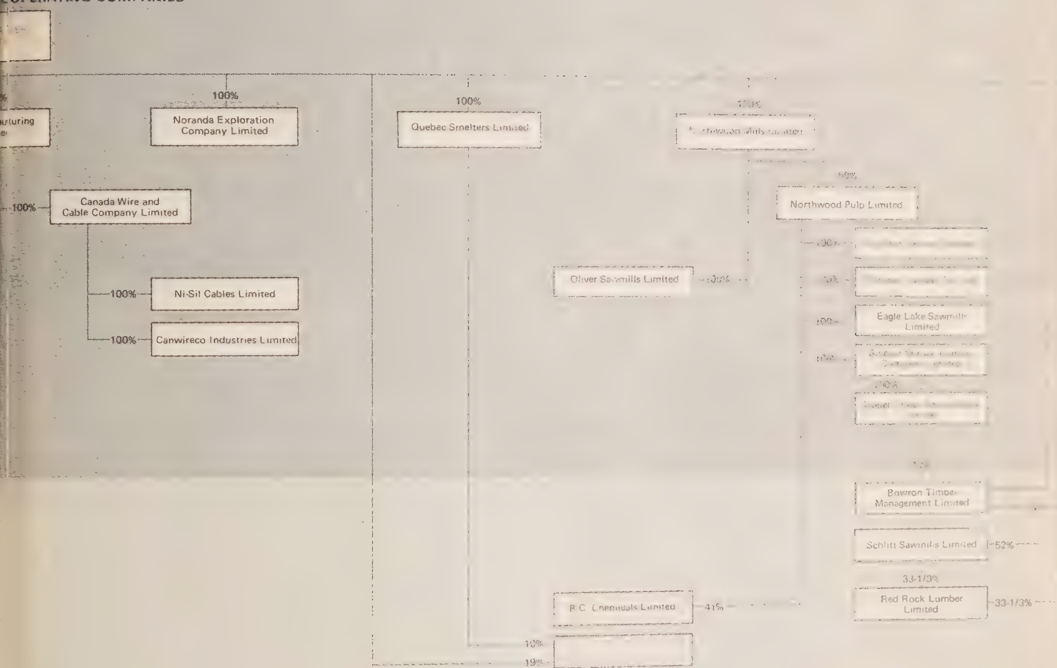


EXHIBIT C
NORANDA
WIDELY A
DOMES
SUBSIDIARY AND ASSO
Canadian Copper Refiners Limited
100%
100%
Brynnor Mines Limited
98%
96%
55%
Belledune Housing and Enterprises Limited
East Coast Smelting and Chemical Company Limited
Belledune Acid Limited
27%
46%
49.9%
Canadian Exploration Limited
Canex Aerial Surveys Ltd.
45%
Bell Allard Mines Limited
82%
20%
38%
29%
Normetal Mines Limited
Quemont Mines Limited
63%
80%
Agnew Lake Mines Limited
Placer Management Limited
62-1/2%
9%
9-3/4%
18-3/4%
General Smelting Company of Canada Limited
St. Lawrence Fertilizers Limited
Noranda Sales Corporation Limited
Canplas Industries Limited
50%
The Noranda Copper Mills Limited
Grandview Industries Limited
Coulter Manufacturing Limited
Comco Metal Products Limited
Ocean Foundries Limited
Quebec Iron Foundries Limited
Atlantic Foundries Limited
Norcast Manufacturing Limited
Leaworth Holdings Limited
Wire Rope Industries of Canada Limited
11%
16%
The Incubation Group Limited

…ES LIMITED
…SELY HELD
… FOREIGN
…OPERATING COMPANIES



LEGEND

…NADIAN – 50% or more

…NADIAN – 25% or more but less than 50%

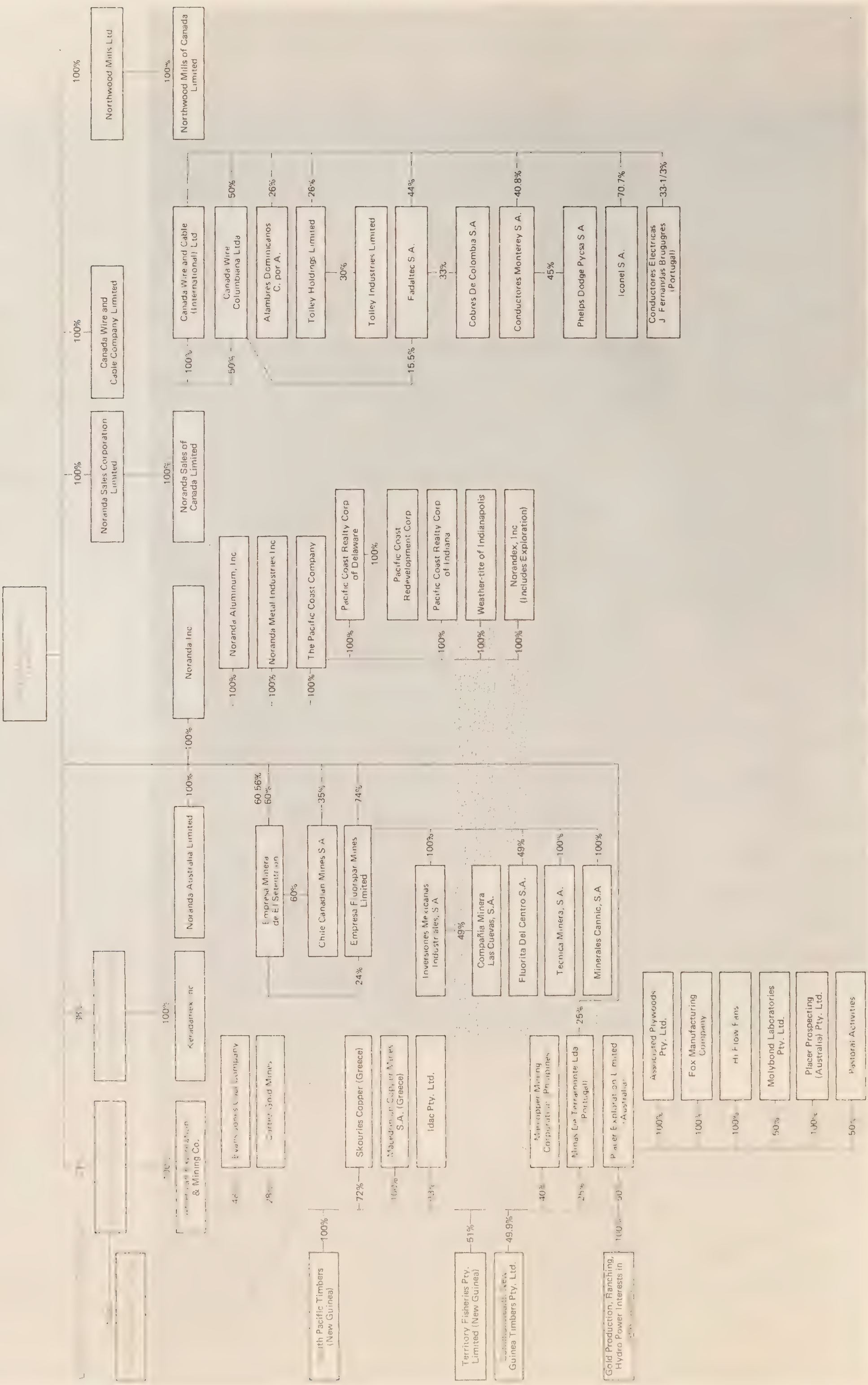
…REIGN HOLDINGS

…lely Held Companies

NOTE:

1. Included in the assets of Noranda Mine Limited are the assets of Central Canada Potash which under an option agreement can be transferred to a separate closely held company once the property becomes operative.
2. These charts exclude many holding companies as well as companies with properties which may someday become operative. Many domestic and foreign exploration companies are also excluded.

EXHIBIT C


Northwood Mills Ltd
Northwood Mills of Canada Limited
Canada Wire and Cable Company Limited
Noranda Sales Corporation Limited
Noranda Sales of Canada Limited
Canada Wire and Cable (International) Ltd
Canada Wire Columbiana Ltda
Alambres Dominicanos C. por A.
Tolley Holdings Limited
Tolley Industries Limited
Fadaltec S A.
Cobres De Colombia S A
Conductores Monterey S A.
Phelps Dodge Pycsa S A
Iconel S A.
Conductores Electricas J Fernandas Brugugres (Portugal)
Noranda Inc
Noranda Aluminum, Inc
Noranda Metal Industries Inc
The Pacific Coast Company
Pacific Coast Realty Corp of Delaware
Pacific Coast Redevelopment Corp
Pacific Coast Realty Corp of Indiana
Weather-tite of Indianapolis
Norandex, Inc (Includes Exploration)
Noranda Australia Limited
Chile Canadian Mines S A
Empresa Fluorspar Mines Limited
Inversiones Mexicanas Industriales, S A
Compañia Minera Las Cuevas, S.A.
Fluorita Del Centro S.A.
Tecnica Minera, S. A.
Minerales Cannic, S.A
Associated Plywoods Pty. Ltd.
Fox Manufacturing Company
Hi Flow Fans
Molybond Laboratories Pty. Ltd.
Placer Prospecting (Australia) Pty. Ltd.
Pastoral Activities
Skouries Copper (Greece)
Idac Pty. Ltd.
& Mining Co.
Territory Fisheries Pty. Limited (New Guinea)
Guinea Timbers Pty. Ltd.
Gold Production, Ranching, Hydro Power Interests in

APPENDIX I

Memorandum on the

MINING TAX INCENTIVES

Prepared by

J. Douglas Gibson

April 22, 1969.

Contents	Pages

Summary

The following memorandum outlines the part played by the mining tax incentives in the growth of the mineral industries of Canada and the crucial importance to the Canadian economy of continuing these incentives in future.

As to the record, it notes:

1. A tenfold increase in the value of mineral production since the end of the war to $4¼ billion.
2. The emergence of petroleum, iron ore, natural gas, sulphur and potash as major minerals to the extent that they now account for over 40% of total production.
3. A great contribution to better regional economic balance. Iron ore in Newfoundland, lead and zinc in New Brunswick, nickel in Manitoba, potash and oil in Saskatchewan, and oil, gas and sulphur in Alberta have been mainstays of economic progress and diversification in these provinces. A variety of mineral developments in the outlying regions of Quebec, Ontario and British Columbia have strengthened the unsheltered areas of the three largest provinces.

4. A strong and widespread impact on the whole economy. In addition to the effects of employing 120,000 people at a payroll of $880 million, the industry's purchases of fuels, materials and services, its capital outlays of $1 billion per annum and repair and maintenance expenditures of $250 million, have had major consequences for many Canadian industries. Mining accounts for over 40% of railway tonnage, it is a major consumer of electricity, oil, natural gas, chemicals, iron and steel and wood products and it has stimulated the growth of the related machinery and equipment industries.
5. An increase in productivity notably higher than in the rest of the economy. Output per employed person in the mineral industries has increased at three times the rate for the whole economy during the postwar period. Mining is the only major goods-producing sector in which productivity is as good as, or better than, in the United States.
6. A massive increase in exports. Mining is contributing an extra billion and a half dollars net per annum to foreign exchange earnings as compared with the early postwar period. In addition,

substantial imports have been displaced by Canadian output, particularly in oil and iron ore.

7. The leading world position of Canadian mining; first in nickel, asbestos, zinc and silver; second in gold, lead, molybdenum, and platinum; third in potash, sulphur, titanium and uranium; and fourth in iron ore, tungsten and magnesium.

8. Integration backward of the Canadian iron and steel industry to a resource base. Here the tax incentives have led a secondary Canadian industry to develop its own sources of ore, thus adding to the strength and efficiency of the steel-making in Canada.

9. Development of strong management groups with the ability to plan ahead, to keep up in research, and to generate and raise capital. The large mining companies and the steel companies are among Canada's few entries in the big league of international companies who have the capacity to generate continued growth.

As to the Carter Report, it observes:

1. That the Report's suggestion that resources of capital and labour turned toward mining by the tax incentives might have been used to better advantage is without foundation. In the light of the record of productivity, growth, regional

balance, and external earnings this allegation seems badly out of touch with the real world. Moreover, some of the capital used would not have been available to Canada at all.

2. That contrary to the implication of the Carter Report, the tax incentives made a major difference in the growth of mining and contributed to stronger and healthier growth of the economy. Without them, the iron-ore industry would be a modest one and many of the nickel, copper, lead and zinc developments would not have gone ahead.

3. That without the incentives, exploration expenditures would have been lower, probably at least 40% lower, and many promising discoveries would never have seen the light of day.

4. That while it is not possible to say precisely how much lower mineral production would have been without the incentives, the reduction would nevertheless have been great. If, for example, the physical rate of growth in output had been 4% per annum instead of the 8%+ rate actually achieved in the postwar period, the value of mineral output in 1968 would have been about $2 billion instead of $4¼ billion. Or if there had been no growth in physical output, production would have been valued at barely $1 billion.

5. That the Carter proposal that incentives, if required, should take the form of subsidies would not make good economic sense in its application to mining. The incentives provide a climate which encourages exploration - they offer good returns on good finds and make some of the marginal discoveries of interest. The incentives provide a flow of funds from successful mining ventures for further exploration and development. Subsidies in contrast provide no adequate incentive to exploration and leave the difficult decisions with regard to development to be decided by government officals rather than by the market.

6. That the Carter Report does not build on the essential connection between economic growth and equity. Slow growth would doom Canada to friction and inequity. Rapid growth makes equity and improving social welfare attainable. Policies that stimulate well-based development in the less industrialized areas, such as the mining incentives, also promote equity in a real sense.

As to the future, it concludes:

1. That the mineral industry, being market and internationally oriented, will respond to the earnings opportunities available to it. Being

Canadian, it has a natural bias in favour of Canadian exploration and development. But if the tax incentives were removed, it would look increasingly abroad. After all, a reduction in the order of 40% in the capital value of ore discoveries in Canada would be a radical change which no competent management could ignore.

2. That once the industry focussed its attention outside Canada, decisions would be made on investments which could not be reversed. It would then take more than the restoration of former incentives and a long time to recover the earlier emphasis on expansion in Canada.

3. That the need for the tax incentives is enhanced by the international shortage of capital. With its proven record of efficient use of capital, the flow to the mineral industries should not be restricted as would be the case if the incentives were removed or reduced. The incentives presently add to the industry's ability both to attract outside (including foreign) capital and to generate savings internally.

4. The the need for the tax incentives is further enhanced by the highly competitive environment abroad. If exploration is not kept up, ore reserves will decline quite rapidly. There are

really no assured markets for Canadian minerals and rapid technological progress brings substitutes and radical change in production. Canada must keep in the van or fall behind. There is no neutral position. It seems wise to build on those foundations where as in mining, Canada already has strength and capacity.

Tax Policy should be Related to Economic Growth

A white paper on tax reform is now planned for June and some important changes in the system were proposed in the budget of last October. While there is no doubt the tax system can be improved, it is most important that changes be considered in relation to the future growth and efficient functioning of the Canadian economy. Considerations of growth and efficiency are particularly important at this time because of the need to adjust to a rapidly changing world environment including developing trading blocks, a high rate of technological advance and increasingly keen competition. The importance of efficient growth is further emphasized because of the need to absorb sharp increases in the working population during the next seven or eight years - increases exceeding those of any other advanced nation.

The Carter Report has advocated changes in mining taxation not conducive to growth and efficiency, including removal of the present depletion allowance and the three-year tax holiday for new mines. These tax incentives have played a major constructive role in the postwar development of the Canadian economy. They have a major role to play in the future, perhaps more important than in the past.

The purpose of these notes is to summarize briefly the remarkable record of the mining industry in the context of Canada's economic growth and to indicate the importance of the part played by the mining tax incentives in this record.

The Tax Incentives have contributed notably to:

1. Marked Increases in Mineral Production. These increases, which have been of an efficient and internationally competitive character, have brought the value of mineral output (excluding structural materials) to \$4¼ billion in 1968. This is almost ten times higher than at the end of the war. The value of production of metals and other minerals, excluding fuels, at just under \$3 billion in 1968, has increased a little less than nine times since 1946. These increases are of course, proportionately much in excess of those for the whole economy and for the manufacturing industries. The increases in the value of production of the principal metals and minerals are shown in the following table:

VALUE OF MINERAL PRODUCTION BY PRODUCTS
(\$ Million)

	1946	1957	1967	1968
Petroleum	15	445	865	933
Copper	47	207	583	593
Iron Ore	7	167	470	556
Nickel	45	259	463	527
Zinc	37	100	322	330
Natural Gas	11	21	311	348
Asbestos	25	104	165	190
Silver	10	25	63	106
Gold	104	149	113	104
Lead	24	51	89	94
Sulphur	-	3	69	81
Potash	-	-	67	74
Coal	74	90	83	61
Uranium	-	136	53	38
Platinum	8	18	35	44
Molybdenum	-	1	38	36

It should be noted that five minerals, practically new in the postwar period, have now become of major importance - petroleum, iron ore, natural gas, sulphur and potash, accounting for more than 40% of all mineral production. Iron ore with an annual production worth more than one half a billion dollars ranks third amongst all minerals in Canada. Uranium came and went during the postwar period, rising to over $300 million in 1959, and is now in a rising trend again. Of the traditional minerals - copper, nickel and silver have each shown postwar increases in excess of ten times and zinc and asbestos have grown nine and eight times respectively. Lead is up four times. Only gold and coal do not fit the pattern of growth; from the positions of first and second in Canadian mineral production in 1946 they have declined to ninth and thirteenth in 1968, and from being 40% of the value of Canada's mineral output in 1946 they have dropped precipitately to 4% of the total.*

2. Better Regional Economic Balance. The most significant aspect of the growth of mineral production has been its contribution to better regional balance. Though this is purely an accident of nature, no other industry in the postwar period has contributed in any comparable measure to improved balance as between provinces and as between regions within provinces. Iron ore in Newfoundland, lead and zinc in New Brunswick, nickel in Manitoba, potash and oil in Saskatchewan, oil, gas and sulphur in Alberta, and lead and zinc in the North-West Territories have been the mainstays of

* In coal, however, the picture is changing as it affects Western Canada where there are substantial new developments in the Rocky Mountain area.

economic progress and of diversification in these areas. A variety of mineral developments in the outlying regions of Quebec, in Northern Ontario and in interior British Columbia have strengthened the unsheltered areas of the three largest provinces. The following table gives a picture of the regional dispersion of growing mineral output

VALUE OF MINERAL PRODUCTION BY REGIONS
(Excluding structural materials)
($ Million)

	1946		1957		1966	
Newfoundland	N.A.		79		319	
(iron ore)		(N.A.)		(58)		(263)
Nova Scotia	33		64		48	
New Brunswick	3		14		78	
(zinc & lead)		-		(1)		(52)
Quebec	70		315		620	
(copper)		(9)		(65)		(150)
(iron ore)		-		(66)		(145)
(asbestos)		(25)		(94)		(152)
(zinc)		(7)		(18)		(60)
Ontario	166		629		1149	
(nickel)		(45)		(248)		(404)
(copper)		(23)		(98)		(278)
(iron ore)		(7)		(41)		(128)
(zinc)		-		(3)		(97)
(gold)		(67)		(86)		(51)
Manitoba	12		49		184	
(nickel)		-		(15)		(118)
Saskatchewan	22		153		361	
(petroleum)		-		(67)		(211)
(potash)		-		-		(74)
Alberta	55		392		1046	
(petroleum)		(14)		(360)		(651)
(natural gas)		(7)		(13)		(302)
(sulphur)		-		-		(78)
British Columbia	69		152		346	
(copper)		(2)		(9)		(79)
(zinc & lead)		(44)		(93)		(73)
Yukon	2		14		23	
North-West Territories	1		22		122	
(zinc & lead)		-		-		(96)

As will be noted Newfoundland, New Brunswick, Manitoba, Saskatchewan, Alberta and the North-West Territories have emerged as important mineral producers. Whereas in 1946 they accounted for only 20% of the total value of mineral output, today they make up half the total. In Newfoundland and in Alberta, minerals have become the leading industrial group, and even in Saskatchewan the value of mineral production is equivalent to over 40% of farm cash receipts bringing much needed diversification to the farm economy. In Quebec, the value of mineral output is up almost nine times, in Ontario the increase is seven times and in British Columbia five times.

In other words, mining growth has worked to sustain and strengthen the least industrialized areas of the country from Newfoundland to British Columbia.* Most of the country except for the industrial belt from Quebec City to Windsor has felt the direct impact of mounting mineral activity.** Thus in a very real sense mining has worked

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* Two recent studies - one on the influence of mineral development on the economies of Manitoba and Saskatchewan by Hedlin Menzies & Associates Ltd. and the other on the growth and impact of the mining industry in British Columbia by Price Waterhouse & Co. - bring out the pervasive influence of mining development in three of the western provinces.

** The industrial areas have benefited indirectly from growing purchases of equipment and supplies by the mineral industries and by the stimulus which depletion in mining has given to steel production and refining of non-ferrous metals.

to lessen the burden of the tariff on the unsheltered areas of Canada. Without this growth and associated economic development, Canada's problems of regional balance would be considerably more difficult than those which we actually face and the cost of the tariff less acceptable.

Of course, this is not to suggest that mineral discoveries and developments conveniently fit the exact needs of the less developed parts of the country. They do not. They are often in northern areas where there are few people available rather than in settled areas with problems of unemployment. Moreover, mineral developments frequently involve the provinces concerned in large expenditures of social capital, and occasionally they peter out. But generally they last and, because they are geared to the necessity of international competition, they add basic strength to the region concerned and generate further economic growth.

Thus, while there are substantial initial costs, the net contribution of mineral development to the less developed parts of Canada has been very substantial. The problems of many such areas would be much more intractable and regional development costs much higher were it not for mining endeavours. For many parts of Canada, mineral discoveries are one of the major hopes of well-based economic growth. And when it comes to the far north,

there are really no other alternatives. Northern development and mineral development become almost the same thing.

3. Widespread Economic Growth. The regional impact of mining growth is evident both in the development and production stages. Mining development means substantial capital outlays and major construction activity both in connection with the mine, and with the townsite, transportation and communication, services and so on. Mining production means continuing employment, heavy outlays for repairs and maintenance, major traffic for the railways, roads and airlines, and stimulus for local industry. Some of the related figures are shown below:

	Annual Average 1966-68
New Capital Investment	
- in the Mineral Industries ($ million)	1014
- as a percentage of gross product	45%
- in Mined-Minerals ($ million)	509
- in the Manufacturing Industries ($ million)	2628
- as a percentage of gross product	19%
Repair & Maintenance Expenditures	
- in the Mineral Industries ($ million)	260
- as a percentage of gross product	12%
- in Mined-Minerals ($ million)	200
- in the Manufacturing Industries ($ million)	1113
- as a percentage of gross product	8%
Payroll in the Mineral Industries ($ million)	810
Number of Employees (000's)	117

With regard to capital outlays two points stand out. The first is that they are large both absolutely and relatively. Though some of the capital spending goes for imports, much the greater part appears in the form of local payrolls, demand for materials and supplies, and orders for Canadian machinery. In addition to these direct capital outlays, there are the large induced capital expenditures for roads, railways, local industry and commerce, housing and community building. The second point about the mining industry's capital spending is the large cash flow necessary to finance it - more than twice as large in relation to production as in manufacturing. The tax incentives are a great help here both because they attract major investment into Canadian mining and because they generate substantial amounts of money internally.

At the production stage, there is the impact of the continuing employment in the mining industry itself. While mining is capital-intensive, it still employs 120,000 in Canada today at an annual payroll of around $880 million. Average earnings are generally quite high and represent the principal source of income in many outlying communities across the country. Then there are the effects of the industry's spending on fuels and materials, and of its outlays for repairs and maintenance which are particularly large in the mined-minerals group where they have averaged $200 million per annum in the last three years.

Not shown in the table is the pronounced impact of mining on the railways - 44% of the total railway car tonnage loaded in Canada in 1967 represented products of the mines. Mining expansion has resulted in the building of several new railways pushing back the frontier, including those in Quebec-Labrador and the lines to Great Slave Lake and to north-western Quebec. Developing mining traffic has worked to reduce the burden of overhead costs of the expensive rail systems crossing northern Ontario and Quebec which not so many years ago were a heavy load on the national economy. Indeed, one of the general effects of mining development has been to fill in some of the empty spaces across the continent thus lessening the burden of overhead costs of transportation, including roads and pipelines as well as railways, of communication, and of public utilities and government services.

The Canadian mining industry is a major consumer of electricity, oil, natural gas, iron and steel products, chemicals and wood products. It has stimulated the manufacture of specialized mining equipment in Canada and many kinds of related machinery. Moreover, the growth of metal production has encouraged Canadian fabricating; one large Canadian producer

of copper now fabricates all its own production in this country.

There is also the effect of mining development on local industry. Obviously the various service industries, like retail stores, garages and utilities come into being in response to the needs of the basic development. Often too there will be growth in other industries such as agriculture and forestry to supply the new demands. Depending on its location and the general economics, the mine may result in a concentrator and sometimes in a smelter or reduction plant. And going a bit farther afield, there is the impact of the mining development on the nearest large centre whose industrial and commercial growth receives a notable impetus, as does Winnipeg from nickel, Saskatoon from potash, Edmonton from oil, and Bathurst from zinc.

Unfortunately, there appear to be few studies available of the detailed impact of individual projects in the areas concerned. Such work would be valuable in assessing the part played by mining in regional development and would be most useful in filling out the picture and in comparing the costs of other possible

policies of regional growth. One such study, of the Brenda mine in British Columbia by Hedlin Menzies & Associates gives a vivid impression of the widespread impact of one project.

4. High Productivity in Mining. Canada has not only been getting, through mining, regional development where it was most needed to strengthen the nation, but she has been getting efficient well-based development. The marked increase in mineral output has been associated with high and rising productivity.

Output per employed person in the mineral industries has increased at three times the rate for the whole economy during the postwar period. In oil and gas, where the application of capital is unusually heavy, the rate of increase has been greatest, but in the mined-mineral area it has also been notably higher than in the rest of the economy. The following table gives the relevant figures:

AVERAGE ANNUAL RATE OF INCREASE IN THE VOLUME OF OUTPUT PER EMPLOYED PERSON

	1946-67	1961-67
Whole Economy	2.5%	2.5%
Manufacturing	3.7%	3.8%
Total Mining	7.3%	4.9%
Metals	4.8%	4.3%
Non-Metals	4.4%	10.0%
Fuels	12.8%	7.0%

It will be noted that over the whole postwar period the annual average rate of increase in the volume of output per employed person in mining, except fuels, was about twice the average for all industries and significantly higher than the average for manufacturing. While the pattern has changed somewhat in the last few years, the general proposition still holds that mining has been performing substantially better than the rest of the economy.

As might be expected from this record, productivity in the mining sector compares very well with other countries. It is in fact the only major goods-producing sector of our economy in which productivity is as good as, or better than, in the United States.* For the economy as a whole, productivity is about three-quarters the U.S. level. If Canada is to survive as a national entity, this gap in Canadian performance relative to American must not be allowed to widen and as a matter of fact the record has not been too encouraging in recent years. Mining is one of the few industries where performance in this vital area is right up to the U.S. level.

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* A paper by Arthur J. R. Smith, Chairman, Economic Council of Canada given to the Canadian Institute of Mining and Metallurgy on March 27, 1967 is the source of this statement and provides a very interesting analysis of productivity in mining.

5. External Strength and Viability of Economy. From a national point of view, the growth and competitive strength of the mining industry have contributed in a major fashion to the external viability of the economy. The value of mineral exports has risen roughly in proportion to production being about nine times the 1946 level. Consistent year by year expansion in mineral exports has provided a mounting and reliable source of foreign exchange. This has added to Canada's ability to obtain needed imports and lessened her vulnerability to unfavourable external changes. The following table shows exports of mineral products in relation to total exports and the current account deficit in the balance of payments with all countries and with the United States.

($ Million)

	1950	1957	1967
Exports of Basic Mineral Products (excluding oil & gas)	469	1087	2048
Exports of Basic Mineral Products (including oil & gas)	469	1230	2570
- as a percentage of Total Canadian Exports	15%	25%	23%*
Current Account Deficit in Balance of Payments			
- with all countries	319	1451	543
- with the United States	385	1579	1491

* The decline in this percentage reflects the auto pact with the United States which by rationalizing the industry has resulted in a very large movement of autos and parts across the border thus much enlarging both total Canadian exports to and imports from the United States and reducing the proportions represented by other export groups.

In the early postwar period, mineral products were considerably less important than farm products and forest products in Canada's export picture, whereas today they rank well ahead of both these traditional groups. They have indeed proved to be the strongest source of foreign exchange earnings for Canada. They have kept the current account deficit in hand and contributed greatly to a less one-sided balance in transactions with the United States. Without the growth of the mining industry and the billion and one-half dollars extra foreign exchange earnings per annum which it has generated, it is hard to envisage how difficult our international financial position might have been.*

6. Leading World Position of Canadian Mining. Another aspect of the growth of mining is the leading position which Canada has come to occupy in world production and technology. Canada ranks first in the world in the output of nickel, asbestos, zinc and silver. She ranks second in gold, lead, molybdenum and the platinum metals; third in potash, sulphur, titanium ore, and uranium; fourth in iron ore, tungsten and magnesium; and fifth in copper where she nevertheless produces over 10% of the world output. Her major mining companies are frequently international in their operations and in a number of cases are leaders in the technology of their

* The $1½ billions is an estimated net figure allowing for imports of machinery and materials used by the mineral industries and for interest and dividends paid abroad on mining investments. The actual increase in mineral exports since 1946 is well in excess of $2 billions.

field. They have developed interests abroad and have played a part in some developing countries thus enlarging the demand for Canadian services and goods. And the Canadian steel industry has become in the short period since the war one of the few healthy steel industries in the world today.

7. Development of a Major Iron and Steel Industry. The mining tax incentives have played an important and rather unusual part in the growth of the Canadian iron and steel industry. Here a secondary industry has integrated back to a resource base. Because of the mining tax incentives, the steel industry has found it worthwhile to develop its own Canadian sources of iron ore, generally low-grade and large-scale, thus replacing ore imports in substantial amount. The depletion allowance and mining tax holiday have added significantly to the industry's cash flow and thus made possible more rapid expansion and greater efficiency in steel-making facilities. This has been of notable advantage to the great variety of steel-using industries in Canada and has led to considerable exports of steel as well as major replacement of imports.

8. Development of Strong Management Groups. Some of the Canadian mining companies are very large and indeed have the characteristics of international companies. In a world where capital is scarce, where research and advancing technology are at a premium, and where long-term

planning and good management are of vital importance, size and strength are major assets. The power to generate and raise capital is of obvious importance in a world where capital is scarce and expensive. The ability to develop improved techniques of mining and of exploration and to discover more effective uses of the mineral products involved is essential in an atmosphere where a widening range of substitute materials is emerging. Planning and good management are the sine qua non of success in the years ahead.

The big mining companies and the steel companies have in fact been profitable and their ability to expand their Canadian operations has been much enhanced by the tax incentives. Their profitability and their high productivity are strong evidence that they are using resources well and contributing notably to Canadian growth. These companies are engaged in exploring, developing and managing mining, metal-producing and related activities. They are not stock promoters looking for quick profits but professionals working for sustained and long-continued development. They represent one of Canada's few entries in the big league of international companies who have the management and financial capacity to generate continued growth.

Most countries are concerned that their businesses are falling behind the great American corporations which are assuming such a major role in world business. Yet many countries are inclined to discriminate against

"big business". If growth and high productivity are what are wanted, they should be encouraged whether they are found in big or small business. If Canadians want to prevent the productivity gap between their country and the United States from widening - a gap which is already disturbingly large - the incentives should not be altered in a way that will go against Canadian development in what is probably our most efficient major industry.

The large mining companies, like other private businesses, will and should employ the resources available to them to best advantage. Though being Canadian, and having such large capital investment in Canada, they will be inclined to search for new opportunities for development in Canada, if the balance of advantage shifts notably in favour of mining development abroad, then their efforts and energies will be directed more abroad. On the other hand, the continuation of the incentives, <u>and the expectation that they will be continued</u>, will keep the emphasis on Canadian development and help generate funds for more Canadian development. There is little reason for concern in this growth-oriented society that the additional funds generated by the tax incentives will fail to find their way into new development. As the mineral base grows, so too will the processing and

fabricating facilities associated with it grow, and indeed, some of the funds may even find their way in to other resource industries than mining as opportunities for development present themselves to the management groups of the companies concerned.

In the present world, Canada does not have a wide area of choice in the pattern of economic development she might like to follow. It would be nice, for example, to have more science-based industries and through persistent effort some progress will no doubt be made though the requirements are exacting and the competition severe. In whatever direction Canada moves, it must be toward internationally competitive and efficient development unless we are content to slip farther behind the United States and perhaps behind Japan and some of the countries in Europe. To keep up, Canada needs industry which has a demonstrated capacity for success or which offers good prospects of success. The mining industry and the steel industry are among the few which meet such qualifications. They are among our best bets for building and sustaining a growing economy even though they may not belong in the "glamour" group.

A Story of Growth and Success

The mining story is a remarkable one. A rapidly rising and increasingly diversified increase in production, an

unmatched and steadily increasing contribution to regional economic balance, a record of productivity second to none in Canada, a great contribution to the external strength of the economy - in the postwar period no other major industry can claim such a record. This is the answer to the suggestion in the Carter Report that capital going into mining might be used to better advantage in some other directions. When an industry's part in the growth of the economy has been so well-based, so well sustained, and so substantial, there is a very strong presumption that tax incentives affecting it are worthwhile and they should not be changed for the worse. This is particularly the case in an economy where other major growth areas are neither plentiful nor easy to identify and in an international economic environment where the competition facing the mineral industries is keen and increasing.

The important thing about the present tax incentives in the mining industry is that they work and work very well. They have established a background which has greatly facilitated the growth of Canadian mining activity. The fact that they work well is much more important than whether or not they fit some ideal plan for a tax system. The Carter Report is concerned that they do not fit the concept of tax neutrality so emphasized by its authors. It is a fact, however, that many other national policies that have worked have not been "neutral".

Indeed, the whole effort to build a country north of the United States with its own identity and characteristics has been an "unneutral" exercise which in some ways has been economic and in others not so much so. Of the mining incentives it may be said that they have contributed to the growth of the country and have been economic as well, i.e. that they have encouraged development of strong economic positions which have both provided a base and a stimulus for further growth.

Objectives of Growth and Equity Go Together

In any case, the idea of tax neutrality is far less important than the objective of well-based growth. While most countries start with the idea of uniform tax rates for different industries, few if any are able to live with such a system without significant adjustments in rates and allowances. The desire to encourage certain activities, such as saving, policies of stimulating growth in particular directions, the endeavour to meet competitive incentives offered by other countries, pressures for protection and help, efforts to assist underdeveloped regions or small businesses, all these and other influences are bound to and do in fact result in a lack of neutrality in economic policy. Neutrality would of course be desirable if there were no other

factors to consider. But where tax neutrality or uniformity conflicts with efficient growth and healthy regional development, as it would in the case of mining, it surely becomes a secondary and relatively unimportant objective.

It should also be emphasized that failure to achieve neutrality does not necessarily conflict with the other major objective of equity. Equity is a concept which applies to the final recipients of income - people, not businesses - and it is extremely difficult and often impossible to determine what the incidence of differing corporate treatment may be. It depends on a variety of considerations. It is clear, however, that if a business receives a tax incentive and as a consequence grows rapidly and strongly, the whole community will gain as well as the owners whose returns are kept in hand by competition. Growth and increasing productivity spread their benefits widely throughout the economy and thus success breeds success.

Incentives that are effective in promoting growth and above-average productivity are worthwhile from the standpoint of the whole economy. They may not only be consistent with equity but may be very helpful in achieving the objective of equity. The achievement of the kind of equity which means anything to people, depends in the final analysis on economic growth. The idea of equity

arrived at by levelling all down to the lowest common denominator is both unacceptable and unworkable. In fact, of course, it is only in a growing and improving economy that the most people have any real chance to improve their lot.

If there is one aspect of the Carter Report that is more disconcerting than others, it is its failure to recognize and build on the connection between economic growth and equity. The Report is more inclined to see conflict between equity and growth than to see their essential compatibility. It would have been much more helpful to search for tax policies which find common ground between equity and growth. For, if we do not achieve economic growth, and if we fail to increase productivity to the degree of which we are capable, we shall have small chance of achieving equity in any real sense. Slow growth would doom us to friction and inequity and make it more difficult to preserve national unity. Rapid growth makes equity and improving social welfare attainable. There should be no real conflict if the two objectives are seen in perspective. They should, and in fact do, go hand in hand provided that emphasis is placed on policies that work rather than on a theoretical structure which finds no counterpart in reality.

It should also be remembered that the problem of equity in Canada is related to regional differences in economic and social welfare. Policies for growth which stimulate well-based development in the less industrialized parts of the country are therefore doubly welcome. As has been emphasized, the mining tax incentives have been most effective in this regard.

Mining without the Tax Incentives

From the very beginning of these notes it has been taken for granted that the tax incentives have a great deal to do with the favourable record of mining. It is stated that without the incentives, the record would have been much less favourable. These are reasonable deductions from the results. The incentives are considerable. The products are highly competitive, if not always with the same product at least with close substitutes. The companies engaged in the business are to an important degree internationally-oriented. They do not have to confine their operations to Canada. Yet the mining industry in Canada has a quite outstanding record in comparison with other major industry groups in Canada. It has shown exceptional growth during a period when international trade in mining products has been growing considerably less rapidly than trade in manufactures and when the

forecasts of the Paley Report have proved to be somewhat optimistic. It has grown in a highly competitive environment where science has discovered substitutes, where new techniques have permitted development of previously uneconomic foreign ore deposits and where cheap transportation has made distant supplies readily accessible. There must be a reason for the good record. Over more than twenty years, it cannot all be luck.

It would be nice to know precisely what the difference would have been if the tax incentives had not been in effect in the postwar period. The difficulty, of course, is that no one can say with any degree of accuracy. The atmosphere of the past cannot be entirely re-created, and one cannot always be sure what the decision might have been in an atmosphere long past. More than that, nobody can know what opportunities for development would never have appeared if exploration expenditures had been lower, as they would have been without the tax incentives.

However, some things can be said with a good degree of assurance. In the first place, it seems likely that without depletion and the new-mine tax holiday, we would have today a modest iron-ore industry in Canada. Whether the original Quebec-Labrador development would have gone ahead is open to question and the principal Canadian

partner says that it would not be a viable proposition today without the incentives. What is even clearer is that heavy additional investment involved in expanding the Quebec-Labrador industry to meet the basic shift in demand toward pellets rather than high-grade ore would not have gone ahead. This was an expensive process and the competitive margin with Minnesota taconite was not great. Moreover, the recent development of large low-grade iron mines in Ontario would not have occurred without the incentives. In short without the tax incentives we should be looking at a rather small iron ore industry, perhaps something in Quebec-Labrador and a modest operation in north-western Ontario, but not the half billion dollar giant it is today.

Coming to non-ferrous metals, a number of the big developments are in the doubtful or negative category. Gaspe copper would not have made sense, some of the Northern Quebec zinc would have been marginal, some of the recent nickel expansion in Ontario would not have been economic and the Thompson development would not have been proceeded with on the basis of what was then known. A good many of the smaller copper, lead and zinc developments would not have passed muster, particularly in view of their highly variable prices and this would have had notable effects in British Columbia as well as in northern Ontario and Quebec. Two molybdenum deposits in British Columbia would not have developed. Some of the asbestos

developments would have been doubtful and one of the two Canadian entries in the potash mining industry would not have materialized. Moreover, some of the developments in base metals, which were proceeded with under the incentives but would probably have not gone ahead without them, turned out after further development to be larger or richer than originally expected. Without the incentives such additional discoveries resulting from development of marginal properties would never have occurred.

However, what casts even greater doubt on what mining production might have been without the incentives is the impact of the reduced level of exploration on discovery. Some of the developments which turned out to be very good would never have been found. The degree of persistence which led to the discovery of a major ore body by one company after twenty years of unsuccessful search in the area might well have been lacking. Mining exploration is after all an extremely uncertain and risky form of investment. One company lost $20 million on exploration over a long period until finally a major discovery was made. Another company has spent almost as much on unsuccessful exploration as it has saved in taxes through the depletion allowance.

How much lower exploration expenditures would have been in the absence of the tax incentives is difficult to say. Looking at the record for a number of companies in the period from 1955 to 1966, Professor Quirin, in a study for the Institute for the Quantitative Analysis of Social and Economic Policy of the University of Toronto, estimates that the net value of mineral discoveries would have been about 40% less had the Carter proposals been in effect. He adopts this percentage as a rough measure of how exploration expenditures might be reduced as a result of the Carter suggestions. The decline of course could well be greater since such a sudden and large reduction in the value of mineral deposits in Canada accompanied by no change in the value of mineral deposits abroad would be likely to cause a more than proportionate shift in exploration activity. It seems pretty clear that the record of mining as the leading growth industry of Canada would have been very different without the tax incentives. And this is to say that, despite the consistency of the Carter principles, the Canadian economy would not have done as well.

Mining is Internationally Oriented

The Canadian mining industry is market-oriented. This is one of the reasons it has done well - it has responded to opportunities as they arose and it has searched them

out. Its sensitivity to the market, however, means also that it is sensitive to opportunities abroad as well as at home. It has a natural bias in favour of Canadian exploration and development because it is based in Canada and because its personnel and attitudes are Canadian. But it is also trying to find the best opportunities; its management is searching for the best practicable returns. At some point, management's responsibilities as efficient operators will lead them toward exploration outlays and development opportunities abroad, if the climate is more favourable, the geology more interesting and the prospective returns better. After all, a reduction in the order of 40% in the capital value of ore discoveries is a radical change which no competent management could afford to ignore.

The Canadian mining industry is already operating abroad - it is one of the leading international industries in this field. If the incentives are changed radically - by the elimination of the present tax arrangements concerning depletion and the mining-tax holiday - the industry must inevitably reassess its position in terms of market standards. It cannot be unaware that the United States offers favourable depletion arrangements, that where iron is concerned Minnesota has been looking for

business, that Australia offers incentives to mining development and that going beyond the boundaries of the more advanced countries, there are a variety of developing countries eager to promote mineral development sometimes with assistance from aid programs.

The removal of the mining incentives might have no very great apparent effect for the time being. Production would continue in many cases at present levels. Few members of the public or business community would notice the reduction in exploration expenditures for a while. The fact that developments which were close to the margin under the incentives were no longer being proceeded with might not be evident for a year or two. Even the companies might resist the logic of the economics to a degree. But as exploration turned up fewer opportunities, as the value of new discoveries was reduced, and as less and less new ventures were embarked upon, mining would become a slow growth and perhaps ultimately a declining industry. How would the Canadian economy look with a slow growth or declining mining industry? - as opposed to one which has been growing at 8% per annum.

To put the picture in perspective, a mineral industry with an annual rate of growth in its physical production of 4% instead of the 8%+ rate actually achieved during the postwar period would in 1968 have had a value of

production of around $2 billion instead of the $4¼ billion turned out last year. If the industry had had no increase in its physical output, the current rate of production would have been valued at less than $1 billion. How would the railways, the machinery industries and many of the less favoured regions of Canada have come out even in circumstances of 4% growth? How acute would our balance of payments problem be? Or would we have been content to relapse into a slow growth under-employed economy which did not require the additional imports which we in fact demanded and got? The Government may have foregone some tax revenues in continuing to provide incentives to mining. But this was a good investment which came back many times in an enlarged tax base* and in lessened requirements for regional and unemployment expenditures. Because of the striking response of the mining industry to the tax incentives and the strong generating effect of mining outlays on the economy as a whole, the net gain in tax revenues must have been very substantial.

Mining Tax Incentives Essential in Future

Looking ahead, there are two added reasons to emphasize the importance of the mining tax incentives to Canada's economic growth. One is the international shortage of capital. It is clearly going to be more difficult, or

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* Both an enlarged corporate tax base in mining, in related industry such as steel and non-ferrous metal fabricating, in supplying industry such as mining machinery, and an enlarged personal tax base. Moreover, the personal income tax base is further increased by the fact that the income of people employed in mining is materially higher than the average individual income in each region of Canada.

more expensive at the least, in the next ten years to get large blocks of capital for mining, or for anything else, than it has been in the last ten. The mining industry has a substantial capital-generating capacity and good external sources of funds, both of which are substantially increased by the tax incentives. Without the incentives, exploration would be less, discoveries fewer, developments less and production and profits lower. The cash flow would be much lower both because earnings would be less and the effective rate of tax higher. And this in turn, would seriously reduce the industry's ability to borrow in the open market, whether in Canada or abroad, and would also reduce Canada's attractiveness as a place to make direct equity investment in mining. Capital which is now attracted by Canadian mining would no longer be available.

The other major reason emphasizing the continuing need for mining tax incentives is the highly competitive environment abroad. There is no assured market for any Canadian-produced mineral product. Even in nickel and asbestos, important new discoveries have been made in other countries and the size of the market depends on competition with other metals and industrial products. Technological progress is so rapid that what appear to be interesting resources today could become uneconomic ten years from now. In short, they might never be developed.

The key point is that opportunities for development will not be known unless exploration is maintained at adequate levels. Ore reserves are probably not being fully maintained as it is. Much of the country has been quite well prospected and there are not many important ore bodies with surface showings still to be found. While the Geological Survey of Canada does an invaluable job in outlining possibilities in new areas, and while new techniques are contributing to exploration, the evidence suggests that new discoveries are likely to involve more effort and more money than has been the case in the past. It will cost a lot to achieve an adequate rate of discovery and to keep up technically. But if Canada does not keep up and push ahead today, it could well be that her comparative advantage in mining will diminish in future. On the other hand, if the effort is made, and if Canada does remain in the van of progress and research, she should be in a good position to utilize to full effect her potentially great mining resources.

To those that argue, as the Carter Report does, that there may be better ways of using scarce resources than through tax incentives to mining, the question is, what are they? The high record of productivity and development in mining is there to see. The generating influence

of mining expansion in our particular kind of economy is also evident, as are the substantial contributions to better regional balance and a stronger foreign exchange position. These are realities not speculations. It is also apparent that Canadians and Canadian companies are good at mining, some of them world leaders. Nobody knows for certain that there may not be some better way of using scarce resources than through incentives to mining development. But we do not know what this better way may be, and meanwhile we do know that mining expansion is a good way of using scarce resources, a way that has achieved good results and paid off handsomely in terms of economic growth. In this competitive world, of giant corporations and big trading units, it is surely common sense to build on those foundations where Canada already has strength and capacity.

It should be observed that if the mining tax incentives were removed, and then because of unfavourable results were reinstated, it might take a long time to regain the impact which the incentives have provided in the past. Mining companies could no longer assume, as they have in the past, that the incentives are part of the economic framework on which they can base long-range calculations of return. They are nervous now in making

such estimates and some ventures have been deferred. As noted earlier removing the incentives would shift the balance toward investment in other countries. Exploration programs abroad would be enlarged and developments would gradually follow. Long-term commitments would be made in other countries which could not be reversed. It would then take more than the restoration of the former incentives to recover the earlier emphasis on expansion in Canada.

In other words, there is a momentum in investment and development. The units of investment are large and made only infrequently by individual companies. Change comes gradually but once it comes it can only gradually be reversed. Thus, if the mining incentives were removed or substantially reduced and then reinstated, it would probably take a long time to regain the earlier rate of growth, and the costs in the form of the loss of well-based economic development in the intervening years would be heavy.

Subsidies No Substitute for Tax Incentives

It is sometimes argued that incentives when desirable for the purposes of national economic growth should take the form of subsidy payments rather than tax remission. The Carter Report argues this general view though it does not advocate subsidies for the mining industry.

The arguments for subsidies as opposed to tax incentives are that it should be possible to apply them with precision at the margin and they should therefore be more effective and less costly than tax incentives.

Whatever may be the merits of the subsidy approach in other areas, it seems improbable that it would be an effective technique when applied to mining. The great merit of the present system of tax incentives is that it provides a climate conducive to mining expansion. The fact that an initial tax holiday is available for new developments and that depletion is applicable through the life of the mine adds very substantially to the return on the investment. This has several consequences. First of all, it means that a good find - and mining people and companies are always hoping - can be very profitable. Every once in a while there is a pot of gold at the end of the rainbow and this is one of the main influences that keeps exploration going. There are few good finds, and even big companies spending millions a year may go for many years without any. Because worthwhile discoveries are rare and so much persistence

is needed, it is important that success be well rewarded, important so long as Canada wants to sustain a level of exploration necessary to a growing and healthy mining industry. Another consequence of the tax incentives is that they make it worthwhile to go ahead with marginal developments which in total add significantly to mineral output and allow fuller use of accessable lower-grade reserves. A further very important consequence of the incentives is that they provide a flow of funds from successful mining ventures available for further exploration and development. These internally-generated funds help to keep the ball rolling and particularly to keep exploration up.

In contrast, it is difficult to envisage a system of subsidies which would provide any corresponding general stimulus and even more difficult to imagine an effective subsidy arrangement in the key area of exploration. It seems unlikely that exploration would receive much stimulus from the knowledge that under some circumstances subsidies would be available for development for a limited period. This is not the kind of incentive either in nature or extent that the present arrangements provide for. No doubt, subsidies would be cheaper in the short run. But then they would not produce anything like the same results and their real cost would almost surely turn out to be higher. If it were to be suggested that exploration might be subsidized directly, the question

arises of how to do it. Are mining groups simply to be given money to explore? Are they to be confined to certain regions? Are subsidies to be related in any way to results? How do you check what has been done? What companies would be eligible? Does nationality or ownership matter? Do profits or size matter? It would be a very difficult type of subsidization, full of problems and not readily related to results.

Though subsidies for development might theoretically be less difficult, they raise the same kind of basic questions. For whom? For how long? For what area? For what purpose? If an attempt is made to be selective, what are the criteria of selection and if it is prospects of success who is going to make the judgment? The men that are putting up the money are often wrong and how is a government official to select among serious and professional applicants? Is there anything in the record to support the view that decisions by officials on such complex economic matters are likely to be better than those of the market? - particularly when the objective is to stimulate growth rather than to meet social or regional pressures? The merit of the present incentives is that they apply to anyone that can produce results. If a discovery is made, if it is developed and becomes profitable, the benefit of the incentives is available. It is the ability to achieve efficient production that counts. There is no question of deciding who get the rewards. There is no question of pouring money into

unsuccessful efforts, of getting into subsidizing weak positions from which it may be difficult to retire.

Thus, to return to the original argument for subsidies as opposed to tax incentives - that they can be applied with precision at the margin and should therefore be more effective and less costly than tax incentives - it is extremely improbable that they can in fact be applied with precision at the margin. It is even more difficult to imagine how they could be designed to encourage exploration as the present incentives do. It follows that while they might be effective in some individual cases their overall effects would be much less than those of the tax incentives.

The choice is not really between two ways of doing the same thing, but between the two fundamentally different approaches. One, the tax incentive route provides an atmosphere, an economic climate for mining within a market system which has been conducive to efficient growth and which has paid off over the years. The other, the subsidy approach, while interesting and even attractive in theory, does not make the grade in practice. It provides no adequate incentive to exploration and leaves the difficult decisions with regard to development to be decided by government administrators rather than the market.

A subsidy system might in the short run cost less in revenue than continuing the tax incentives. But if it failed to sustain exploration and if it substantially

reduced the internal savings of the industry, as in each case it certainly would, the results would show up in retarded growth in a key portion of the economy. Profits would decline and tax revenues with them. It would not be long before tax revenues at the higher rates on the lower profits minus the subsidies would yield less than taxes with the present incentives. External opportunities would become more interesting and more effort and resources would go into exploration and development abroad.

The real question is what do we expect of the mining industry in the future pattern of Canadian growth? If it is to remain one of the foundations of the economy and one of the prime generators of economic growth, then it would be a mistake of major proportions to switch from an incentive to a subsidy system. The incentive system works well. It gets results. Of course there is a cost but there are great benefits. The subsidy approach cannot be designed as an effective substitute. It would no doubt cost less. But it would produce a great deal less in the form of results.

The Record Speaks for Itself

The mining tax incentives are one of the most successful of the many "unneutral" policy decisions in Canada's economic history. They have been encouraging a major staple industry which like wheat, lumber, and pulp and paper has been a potent generating force in Canadian

economic development. The mineral industries have been growing at a time when some of the earlier staple industries have been reaching maturity. They have been having a regional impact of a most helpful nature, filling in the trans-continental economy and providing diversification and strength in the less industrialized areas. They have been stimulating the development of manufacturing both by their purchases of equipment and supplies and by their development of processing and fabricating. In the steel industry, they have been giving impetus to growth and greater efficiency. And finally, they have greatly strengthened Canada's international position.

In the actual world, the mining tax incentives have produced good results for Canada and promise to produce good results in future. To a large degree the record speaks for itself. Yet the Carter Report suggests that these tax arrangements should be discarded for reasons that are highly theoretical and not related to the actual circumstances in which Canada has to compete and grow. It would almost seem as though the Report regarded these incentives as of minor importance, as a suitable area for tax experimentation, whereas in fact the stakes are very high indeed. Here is one of the principal elements in our economic growth. Are there so many other strong growth positions in our economy that we can afford to take chances like this?

APPENDIX II

The Honourable Mitchell Sharp,
Minister of Finance,
Government of Canada,
Ottawa, Ontario.

Sir:

This submission comments on the recommendations of the Royal Commission on Taxation. Although we have met your deadline of September 30, our study of the Report continues, since it is just too massive, detailed and all-embracing to be understood in all its ramifications in the time available since its release. Accordingly, it would be presumptuous of this one company to comment in detail on more than those of the 12 points you have outlined which affect it the most, except in a general way.

Our submission is divided into five parts as follows:

I Some general views of the underlying philosophy of the Report and the probable resultant difficulties.

II Comments on the Report's conclusions respecting the mining industry as a whole.

III An outline of the principal distinguishing features of the mining industry.

IV An appreciation of the significance of present tax legislation relating to mining companies.

V A summary of the progress of Noranda under existing legislation and case histories of the active mining companies in the Noranda group.

Part I - Noranda's general view of the Report

The whole thrust of the Report is postulated on acceptance by Canadians of a tax system which:

1) Would favour those individuals with large investment incomes but at the same time seriously inhibit or even destroy capital formation by individuals. As a consequence of the integration of corporate and private incomes, the man in the range of $12,000 - $20,000 income from dividends would most probably receive a refund on account of taxes paid on his behalf by the companies whose shares he holds, while the man in the $12,000 - $20,000 salary range would get no such relief. Regardless of our antipathy to double taxation, it simply does not seem to us realistic that such a system would last for very long.

Admittedly the advantage would gradually diminish as the investor passed his wealth on to his family at a cost approaching 50% and also paid 50% tax on any capital gains he was able to make, as well as those resulting naturally from inflation. The confiscatory nature of this treatment would surely not only soon reduce present private capital but would prevent or at least discourage future capital formation. In our view it really goes without saying that such capital is essential to private enterprise in a developing country.

2) Would have a devastating effect on much of the development of Canada's mineral resources by private enterprise and put much of what would remain in the hands of government. Removal of incentives to explore and invest and substituting therefor some kind of a system of grants or subsidy could only impair the development of Canadian mineral resources.

3) Would seriously impair the capital formation by corporations now possible in the extractive industries. In a free enterprise system capital is an element essential to the development of the country - particularly in a high-risk industry such as mining. To eliminate the tax exemption and depletion allowances would be to classify mining almost as a service industry by removing those elements of the present system most important to capital growth and investment.

4) Would penalize foreign equity investment in Canada and discourage, if not effectively stop, any further foreign investment, leaving a burden beyond the capacity of Canadian equity investment resources. While Canadian equities would be rendered more attractive to Canadian investors, the reverse would apply to foreign shareholders, who would probably dispose of their holdings as quickly as possible. The resulting absorption of available Canadian investment funds would seriously restrict any new financing in Canada, including government borrowing. The proposals not only suggest a breaking of faith with those who have already invested, but would also restrict Canadian access to badly needed capital. It seems unrealistic to expect that capital needs can be met by foreign borrowings without some reasonable equity participation.

Regardless of theoretical views, we do not believe, however desirable it might be to the higher economic development of the country, that funds would be diverted from resource development into secondary industry merely by making the former avenue unattractive. Mining capital is experienced in, and predisposed to, the risks of mining. It is like the man who prefers speculative real estate to savings bonds or the other who prefers to spend his excess cash on

pari mutuel tickets instead of stamp collecting. To the prospector, developer and miner, private or corporate, the possibility of the really big win is the incentive. While such prizes are very rare, the prospect keeps thousands of men spending millions of dollars examining countless acres of property throughout Canada. This money and these men are going to be where best chances of reward exist.

At the same time, it is important to measure the degree to which secondary industry grows following development of primary resources. The so-called multiplier effect of new spending in an economy affects secondary employment in the immediate locality, the region and then the whole country. It is generally accepted that two to three secondary jobs result from each primary job. While the brief of the Mining Association of Canada covers this point in detail, it is fair to note that the growth in metal mining (excluding gold mines) has been nearly 4.5% annually since 1949. Compared to the 1.8% expansion in manufacturing employment and the 2.1% industrial composite, this is a highly desirable achievement for Canada. The combination of the growth rate and the multiplier effect suggests that present rules foster a degree of growth in mining that would be desirable in other phases of the economy also. This of course has already been recognized in some of the government's depressed area legislation.

We conclude that much of secondary industry in Canada is based on mining development but that exactly how much is impossible to measure. Over the years Canadian secondary industry has probably developed, and it should continue to develop, to the extent of the domestic and export markets available to it. Canada has been

developed on a natural resource base and when one looks at the map of Canada and realizes how much of it is potentially productive of mineral resources only, to follow the recommendations of the Report is to deny much of the land mass of this country and thus much potentially rewarding development.

We should make a further comment on foreign investment in Canadian resources. Noranda has no direct interest in one part of this problem, as it is 89% Canadian owned, but it has recently been increasing the international scope of its operations. Its operations have been integrated from mine to market, to the degree that now its manufacturing interests must look to U.S. and foreign markets for further growth. This is a natural thing and desirable, and in the long run will only bring wealth to Canada. However, the Commission's proposals, by making income from foreign sources less attractive, would militate against further growth in such international operations and would work toward the economic isolation of Canada.

As a final general observation, it was our understanding that the Commission was asked to reform the present tax system. It seems to us that they may have gone well beyond these terms of reference in recommending a whole new system which will be basic to the kind of social order they believe to be most desirable. We cannot discuss such broad issues here, however, we do believe that most of the weaknesses in the present tax system can be corrected by suitable amendment. The impact of the system can be adjusted through rates and allowances and the technical defects can be cured, as, for example, the recent elimination of excessive surplus stripping.

The possibilities of upset, injustice and disorder inherent in the radical and complex proposals of the Commission, as compared to the present system, which works, even though imperfectly, suggest the greatest caution.

Part II - Comments on the Report's conclusions respecting mining

1) The Commission states that Canadian mineral reserves are adequate for current requirements and that for most minerals the reserves are growing rather than declining relative to current output. This is a sweeping generality which does not apply to the base metal industry where, only to maintain present production levels, new sources of output must be developed in the next few years to replace mines now approaching exhaustion. In relation to production, Canadian reserves of base metal ores are substantially low compared to those of other countries with important output and are in no way adequate for the projected growth of use of copper, zinc and lead by 1980. Considerable authority backs the view that we are drawing on reserves of ore faster than we are replacing them and, except for special instances, an increasing rate of discovery is vital. Our views and those we quote are founded on the most basic facts and compel a searching scrutiny of the Commission's statements regarding ore reserves. These latter appear to be based on an individual opinion of ore reserve trends in only one Canadian province.

2) The Commission's conclusions that the so-called special concessions to the mining industry are inefficient and undeserved are not supported by the realities of the Canadian economy. We believe that all Canadians should clearly understand that all resource based industries benefit from some form of government assistance and the extractive industries are by no means the favoured few. The latter have benefited from the services provided by the Federal and Provincial Departments of Mines, government assistance in opening remote areas and tax incentives. Forestry has received provincial grants of large

tracts of woodlands and provincial maintenance of these in the form of fire protection, disease control, silviculture, etc.. Agriculture has received all manner of benefits, including grants of land to homesteaders, a government-operated wheat board, subsidies, price maintenance, income averaging and credit assistance. Fisheries receive everything from income averaging to shipbuilding subsidy. These benefits, instituted deliberately and carefully by Government over a long period, have provided the conditions requisite for development of natural resources, so that the products therefrom might compete in world markets. Little if anything can be done within Canada to control the price of many of the resultant products and the basic economics of nearly all Canadian resource development depend on world supply and demand.

Also, virtually all other Canadian industry benefits in some way from such things as protective tariffs, anti-dumping legislation, municipal, provincial and federal encouragement, including tax incentives, development grants, research assistance, etc., etc.. It is not possible for us, or probably for anyone, to properly measure the relative value of one benefit against another because of the widely differing factors involved.

However, all of these government introduced measures have had their part in the growth of the economy as they were intended to do. Since Confederation government policy has been to maintain conditions designed to allow Canada to stand in the world economy. It began with the building of the railroads and canals and continues with these, Air Canada, depressed area legislation, shipbuilding subsidies, and so on.

The incentives to mining companies are really, amongst other things, an offset to the protective tariffs. While, for example, the automobile industry operates in Canada with this kind of protection, the metal industry operates in the unsheltered area of the economy. World prices rule the metal industry and Canadians must either produce metals competitively or import them.

3) The Commission's statement that about $150,000,000 of tax revenue from 8 companies was lost during 1964 because of the tax exemption and depletion incentives seems to us a selective and misleading use of statistics.

What was not said in dealing with this point was that a part of the profits giving rise to this so-called loss of tax revenue came from mines which would never have operated without the tax incentives. Of course this situation cannot be assessed with any certainty, but later we outline some specific examples. The fact is that existing incentives have made a much larger industry than would otherwise have been possible. This in itself means a wider tax base within the industry, to say nothing of personal taxes on the increased employment and the expanded secondary industry mentioned previously.

4) Mention has already been made of our belief that capital has a personality and that which is devoted to mining enterprise will stay in that field regardless of nationality. To demonstrate, one should note the increasing Canadian exploration investment in Australia and Ireland, the migration of South African diamond and copper capital into Canadian mining and the common ownership of American and South American base metal companies.

But not only does the capital have a personality, so does management. Noranda for example has, over the years, built a management with capabilities covering all phases of the industry. This group is skilled in exploration, mining, milling, smelting, refining, finance and management and is trained to seek, negotiate and develop new or unrecognized opportunities. This in itself is a Canadian resource and one which would suffer if it becomes more advantageous to be in the mining business in other parts of the world than in Canada.

5) The suggestion that the incentive legislation could be replaced by subsidies is not, in our view, realistic. The certainty of the present incentives encourages the original costly search to find and explore an orebody and later is an essential factor in assessing the economics of the deposit. A subsidy which may or may not be available in the event that a mine is found would be of little interest to the prospector. To illustrate the thinking with regard to subsidies, a subsidy of the magnitude suggested by the Report as a transitional provision to compensate for the elimination of the three year tax-free period of $1,000,000 might be significant to the economics of a very small mine, but in view of the capital required to bring most mines into production, it would be a trifling consideration in most feasibility studies.

Under existing rules a good deal more financial certainty is possible in projections of a new operation. The prospect of early and enlarged cash flow has encouraged the building of modern and efficient plants which have given mining a record of productivity as good as or better than any industry in Canada. This vital factor in

the growth of a country was the subject of an address to the Mining Industry on March 27, 1967 by the new Chairman of the Economic Council of Canada, Mr. A.J.R. Smith.

Finally on this point, the Report's recommendation to award subsidies by government agency places a decision in the hands of those who, no matter how genuinely concerned with the development of economic and efficient enterprises, cannot possibly have the experience and feel necessary to properly assess new mine developments. Noranda firmly believes that incentives based on performance result in more efficient use of funds than would be achieved by subsidies, which by their nature are not an incentive to efficiency.

6) Nowhere do we find in the Report that any attempt has been made to evaluate the benefits which Canada has enjoyed and the tax revenue received from mining operations which, except for the tax incentives, would not have been established. There is no assessment made of the high productivity of the industry, which, as mentioned before, has been as good as or better than other segments of Canadian industry. There is no suggestion of where the capital employed would have been better invested or as productive. In fact, very little has been said to support the theory of misallocation of resources.

There is what amounts to an assertion that the economy would not be adversely affected if the incentives to mining were removed. Noranda rejects this as unreasonable and unrealistic and believes that its own significant and expanding contribution to the economy demonstrates the success of the stimulus provided by the incentives in the years since 1948. As well as following this point

in the remainder of this brief, we respectfully draw your attention to the brief of the Mining Association of Canada to the Carter Commission dated March, 1965.

Part III - Distinguishing Features of the Mining Industry

This section is a brief review of the factors peculiar to the development of new mines. The problems are those of location, transportation, recruiting and accommodating personnel, uncertainties of mining conditions and ore treatment and, finally, volatile metal prices.

1) We do not propose to discuss the primary phases of the mining business, the searching for and finding an economic ore body, as we believe there is a general appreciation of the high costs involved and the long odds against success for any one exploration project.

Given a mineral discovery, it must be examined to confirm the presence of ore in quantity and commercial grade and amenability to treatment for recovery of its valuable constituents. If these and other factors are favourable, ore definition by diamond drilling and, usually, underground development will be carried far enough to indicate the potential magnitude of the deposit but, in any case, to prove tonnages of ore sufficient to promise return of the expenditures necessary to bring the property into production. Tonnage potential is one of various considerations in determining the tonnage rate for the operation.

To minimize preproduction costs and reduce the financial risk involved, preliminary ore definition is usually held to the minimum necessary to provide the basic information required. Final ore definition can be done more efficiently and cheaply as the mining operation progresses.

A mine entering production may encounter difficulties which could not be foreseen. Poor ground conditions, ore irregularities, heavy water flows, etc., may result in higher mining costs than expected and dilution may adversely affect ore grade. Problems in treating the ore, which were not evident in prior laboratory testing, may result in costs higher or metal recoveries lower than counted on. An operating loss is normal for an initial period of weeks, or possibly months, while ordinary problems are being solved and the whole operation coordinated, but in some cases the difficulties are serious enough to force abandonment of a new operation.

2) Above all, when ore, concentrate or metal is finally produced, there is little or no control over prices (see Appendices), which are subject to world forces of every kind, including wars, depressions, boycotts, embargoes and technological change.

Temporary suspension of production due to low metal prices presents difficult problems. Either a substantial part of the work force must be retained and the mine and plant maintained ready for quick resumption of production, or the shutdown must be complete. In the latter case, reopening will involve much time and expense in reassembling and organizing a work force, restoring plant and equipment to operating order and, if an underground operation, dewatering the mine, reinstalling underground equipment and recovering the mine workings. The difficulties are more serious in remote locations. If finances permit and prices are expected to recover in a reasonable time, the tendency is to restrict production and accept operating losses pending price recovery.

3) Usually, mines are found in remote locations which require all manner of company subsidies in assembling a competent work force. This includes creation of a townsite and housing, premium wages, medical facilities, recreational facilities and extraordinary transportation costs. Although the Commission made no attempt to evaluate this factor, in our experience the municipal costs involved in opening a new mine are very much higher than those for a secondary industry in an established community.

4) While the new technical equipment and methods which are becoming available for detecting ore bodies concealed by overburden will probably result in the discovery of some new mines near established communities, it is a fact that most mines are found in remote places involving all the difficulties and costs inherent in the location. In any case, experience to date with the new techniques is that, for each viable ore body found, some thousands of false leads have been investigated, meaning a very high cost for each success. As compared to a secondary industry, which is free to locate to its best advantage, a mine is where you find it and any problems involved in the location must be accepted.

Part IV - The significance of present tax legislation

1) A tax on capital gains, by reducing the potential reward, would discourage the kind of speculative investment necessary in mine development and prospecting. Imposition of such a tax would simply blunt an existing spur to private enterprise and we see no justification for any such action in a developing country. Much of what sometimes appears as capital gain is simply the effect of inflation.

To tax the dollar arising from risk-taking at the same rate as the dollar earned from employment appears highly unrealistic and would certainly reduce the amount of capital available and willing for risk investment. On the other hand, it is very doubtful if the revenue accruing from a realistic rate of capital gains tax would balance the fantastic administrative difficulty and expense inherent in the Commission's proposal.

2) In addition to the risks inherent in new mine development, there is the pre-eminent fact that every mine is a wasting and non-renewable resource. Together these factors have always combined in the market place to demand a high rate of return on invested capital as compensation for risk and mortality.

In consideration of the nature of the industry, it is clear that the tax exemption, relative to the depletion allowance, generally forms the immediate incentive for bringing a base metal mine into production. The tax exemption is more important to short-lived mines, while depletion may be the bigger factor for those of longer life.

The Report infers that mines which, because of short life, never pay taxes, are of no value to the country or at least represent

a misallocation of resources. There is no recognition of the fact that many mines, which initially had short life expectancy, have grown into major producers or have sparked the discovery of other producers. As examples of this, there are in our group Kerr Addison, Waite Amulet, Normetal and Noranda's Horne Mine. But even if a mine does not develop to the point of paying federal taxes, it does pay provincial mining duties, create employment and business for secondary industry and contribute generally to the national economy.

3) While the benefits from the present incentives may appear excessive in a few instances where high grade ore, long life or high metal prices combine with other favourable factors, it should be kept in mind that these are the rare prizes which inspire the search for new mines and which must make up for the massive expenditures on unsuccessful exploration as well as the many mines which fall short of returning their invested capital. The results of the incentives are clearly demonstrated by the growth of the mining industry and its increasing part in the national economy. It could be imprudent to prejudice such a potential because of a few anomalies.

4) The matter of depletion is very hard to determine equitably, since there is no positive yardstick by which one can measure the value of this provision. The basic concept of providing for the replacement of a wasting asset is, however, sound and recognized in every country possessing a significant mining industry.

In the case of Noranda, the depletion allowance has permitted a tax saving since 1948 of approximately $28,000,000. During the same period Noranda has spent $24,000,000 on unsuccessful exploration

projects. It is a matter of judgment whether or not this is a reasonable quid pro quo; however, Noranda feels that, when this amount of $24,000,000 is added to the exploration and development expenditures it has been able to capitalize in a very few productive properties, the result will justify the depletion allowance. In other words, the allowance to Noranda for the wasting of its resources has been employed to replenish them by new discovery. It has also permitted a satisfactory return to investors.

Having thus outlined the general significance of present tax legislation to the mining industry, there follow several abbreviated histories of developments within the Noranda group which are intended to illustrate the importance of the tax exemption and depletion allowances.

In appraising the economics of an orebody, most companies throughout the world use a discounted cash flow method. This involves estimating the net cash flow which the orebody will produce over its indicated life - i.e. net profit plus non-cash charges less an allowance for capital expenditures required to maintain production after operations commence. If the present value of this net cash flow, calculated at an appropriate rate of interest, exceeds the cost of bringing the orebody to production, the project is considered to be economic.

Such a calculation involves a great deal of guesswork and is thus subject to a considerable margin of error. The long lead time required to place a mine in production requires that construction conditions and equipment prices must be estimated several years ahead,

and inflation often results in substantial capital cost overruns. The uncertainties mentioned earlier concerning underground conditions, metallurgy and particularly metal prices can make a mockery of cash flow projections. Mining is capital intensive, and the capital required must be largely committed before these uncertainties can be resolved.

The degree of risk obviously varies from property to property depending on the location and nature of the ore deposit, and the judgment of the developer as to the degree of risk involved is reflected in the rate of return required. As a general rule, a rate of return of 12% to 15% is required by the industry for North American deposits, but in some cases where the risks seem less severe than normal, a return as low as 10% may be accepted. However, an orebody with a potential return of less than 10% would almost universally be considered uneconomic, and this rate of return has been used in the examples which follow.

Brynnor Mines Limited

MacDonald Mines Limited spent $2,300,000 in proving a pyrite orebody with low zinc values. The property then lay idle for several years.

In 1953, Noranda and MacDonald formed West MacDonald Mines Limited to undertake production based on a promising outlook for pyrite which indicated a marginally profitable operation.

Production began in October 1955 after the expenditure of $2 million which was advanced by Noranda.

In 1959, low prices for pyrite and zinc forced cessation of operations. The accumulated cash gain was $1,360,000, some $640,000 less than the cost of bringing the mine to production. Preproduction expenditures and capital costs unclaimed for tax purposes were $3,580,000.

In 1962, West MacDonald changed its name to Brynnor Mines Limited and acquired an iron mine at Kennedy Lake, B.C. from Noranda, which had spent $12,800,000 to bring the open pit project into production. Production of iron concentrate for shipment to Japan began in May 1962 and continued until July 1966 when the mine was closed by strike. During this period, expenditures of $3,800,000 were made for shaft sinking and preparations to have underground ore available on exhaustion of the open pit.

While the economics of the underground project were sound when it was begun, due to water and ground problems in the mine but mainly to burgeoning labour costs in B.C., the situation had deteriorated and when the strike began the prospects were only marginal. Continuing worsening in the labour situation left little hope of recovering even the estimated $3 million yet to be spent to complete the underground preparation, and this project was abandoned. Mining in the open pit was resumed in March 1967 to recover some remnants of ore and the whole operation will terminate about the year end.

In summary, $16,600,000 was invested in this iron project. The cash gain from production has been $21,680,000 and there will remain some $5,880,000 of capital expenditures unclaimed for tax purposes. Included in the cash gain is an amount of $2,195,000 of

tax savings made by Noranda prior to sale of the property to Brynnor, through write-offs available under the present system.

If the Kennedy Lake project had been independent throughout, the results to date, based on actual experience, would have been as follows:

Under existing tax provisions

Capital invested (over period 1960-1966)	$16,600,000	
P.V. capital invested @ 10% at commencement 1962		$16,200,000
Net return - cash flow	$19,500,000	
Net return - P.V. 10% 1962		$16,500,000
Unclaimed capital cost & development		$12,250,000

The operation would have returned 10% on its investment which would have probably justified the capital risked.

Under Carter Proposals

Net return - cash flow	$15,999,000	
Net return - P.V. 10% 1962		$13,272,000
Unclaimed capital cost & development		$ 3,445,000

Even after claiming all terminal losses provided for in the Carter recommendations, to minimize the tax, this property would not have been brought into production.

In 1965 Brynnor acquired, from Noranda, the Boss Mountain molybdenum property. This had previously been examined by three major mining companies and rejected as being uneconomic, but Noranda spent over $1 million in detailed examination and proved about

1,750,000 tons of good grade ore. This justified going into production which was achieved in 1965, but a heavy over-run due to faulty estimating and drastic cost escalation had resulted in capital and pre-production costs of $12,200,000. While this amount would probably have been acceptable in the original economic assessment based on the present incentives, application of the Commission's proposals would have killed the project at that time if, indeed, it would ever have been originated.

The Boss Mountain operation is proceeding normally, except that the ore grade is slightly lower than forecast. About half of the capital invested should be recovered by the end of the tax-free period, but more ore must be found to enable recovery of the full amount.

The history of Brynnor and the preceding companies is a good example of the risks and vicissitudes of mining which justify the present tax incentives.

Gaspe Copper Mines Limited

The copper showings on this property were discovered in 1922. Over the years the occurrence was looked at by many mining companies and rejected because of apparent low grade and the difficult isolated location. Noranda carried on diamond drilling in 1938 and 1939 and indicated substantial tonnages of sub-marginal material. Work was resumed in 1947 following the war, and in 1948 and 1949 was successful in proving more tonnage and slightly increasing the average grade of ore. A study in 1952 indicated a cost of $31 million to bring the property into production and, assuming the present incentives,

gave a present value of $30,100,000 for the net return over 33 years, discounted at 10%. On the basis of the Carter proposals, however, the present value would have been only $25,900,000 and the project would have been abandoned or, at least, shelved.

With some further encouragement from drilling, it was decided to proceed to production on the basis of estimated pre-production and capital costs of $33,000,000. As not unusual in such locations, unforeseen problems were encountered and the final cost was about 50% higher than estimated. Fortunately, operating costs turned out to be lower, and metal prices higher, than could be forecast at the time.

Production began late in 1955 and operations were severely affected during the first year by hydro power failures and during the second and third years by a seven-month strike and prolonged period of recovery. The benefit of the tax exemption was diluted accordingly.

With a debt of $47 million at the start of production and further capital expenditures of $9 million, it was not until mid-1963 that the company fully repaid its obligations. The first dividend was paid late in 1963, over 25 years after the initial expenditure on the project.

To the end of 1966, $15 million was paid in income and production taxes and $11,925,000 in dividends. By the end of this year some $15,000,000 will have been spent to bring the nearby Copper Mountain mine into production.

Gaspe Copper provides employment directly to nearly 1,000 persons and injects over $5 million in wages annually into the economy of one of Canada's worst distressed areas. Its custom smelting facilities have played a definite part in the opening of several mines in New Brunswick and Newfoundland. All this, plus very substantial indirect benefits to the Canadian economy, has come from a project which, except for the present incentives, would have been set aside in 1952.

Mattagami Lake Mines Limited

Orchan Mines Limited

These adjacent deposits of zinc-copper ore were discovered in 1956 about 125 miles north of Noranda, Quebec, and funds for secondary exploration and development were provided in part by Noranda. The decision to place these properties in production and to build a related zinc reduction plant at Valleyfield, P.Q. was made in 1961, the estimated total capital required being $55,500,000. Debt financing was arranged with Noranda's participation, and first production was achieved during the fall of 1963.

At the time the decision was made to place the Mattagami Lake property in production, the present value at 10% of projected net cash flow over the life of the mine was $55,300,000 compared with a capital requirement of $43,000,000, so that the property was clearly economic. Had the Carter proposals been in effect, the present value at 10% would have been only $42,900,000 and having regard to the risks involved, particularly as to zinc prices, the project would have been considered marginal. The decision as to whether or not to proceed would have been difficult.

In the case of Orchan, the present value at 10% of projected cash flow was $23,600,000 compared with a capital requirement of $19,300,000. The Carter proposals would have reduced the present value at 10% to $18,400,000, making the orebody clearly uneconomic.

Noranda Potash Division

In 1964, Noranda decided to enter the potash mining business and purchased a partially proven property near Saskatoon, Sask. for some $7,500,000 in treasury shares. When further drilling confirmed the presence of a major deposit, the decision was made to place the property in production at the rate of 1,200,000 tons of product per year. Work began in 1965, with full production scheduled for 1970.

When the decision was made, the capital cost (including accrued interest) by the time of reaching full production, was estimated at $95,300,000, against which the projected cash flow at 10% interest had a present value of $119,200,000. Under the Carter proposals, however, this present value would have been reduced to $95,400,000. Having regard to the large amount of capital required, the very long lead time, the hazards of shaft sinking in Saskatchewan and the existing uncertainties concerning marketing, a rate of return well in excess of 10% was necessary and, without the present incentives, the capital would not have been risked.

Normetal Mining Corporation, Limited

Normetal is a copper-zinc producer. It was a high risk venture brought into production in 1937 with only a small ore body which had very limited life expectancy, but which, as mining has

progressed, has shown unusual persistance in depth. The property was acquired from its previous owner, Abana Mines Ltd., by foreclosure of a mortgage in 1931 when further financing was unavailable due to the discouraging results of exploration at that time.

A programme of underground exploration along with metallurgical testing was pursued and ore reserves sufficient for over three years' operation at 500 tons per day were proven. Although there was no assurance of recovery of the investment at the low metal prices then prevailing, a plant capable of handling 250 tons of ore per day was built and put into operation in 1937. In 1938, the capacity was increased to 500 tons per day and, in 1940, at the Government's request and with tax credit assistance, plant capacity was again increased to about 1,000 tons per day.

After nearly 30 years of operation, ore reserves at the end of 1966 were 1,637,000 tons, sufficient for approximately 5 years' operation at the present rate of 920 tons per day. The mine has reached a depth of 8,000 feet.

Without tax incentives, this mine would not have come into production. Because of the requirement that development and depreciation be written off during the tax-free period and due to falling metal prices after production commenced, there was no tax-free income in this period. However, the incentives were available and this company is an example of a mine which was very small initially but which has made, and continues to make, a worthwhile contribution to the Canadian economy.

Normetal to the end of 1966 has:

a) Paid salaries and wages amounting to $43,100,000 (current payroll - 500 men - $2.8 million annually)

b) Expended on supplies, power and freight $39,000,000

c) Paid income and production taxes of $17,400,000

d) Paid corporate and municipal taxes of $750,000

e) Paid dividends to its shareholders of $28,200,000, 98% of whom are Canadian

f) Produced -

202,400	tons copper
427,800	tons zinc
12,178,000	ozs. silver
134,000	ozs. gold

with a net value of $143,200,000.

g) Participated in the financing of the Geco Mine, a large copper-zinc producer in Ontario; is one of the owners of a zinc reduction plant at Valleyfield, P.Q., and was the first mine to open a market for Canadian zinc concentrates in the Eastern United States.

Kerr Addison Mines Limited

Kerr Addison Mines was incorporated in 1936 to develop a gold occurrence which, since its discovery in 1907, had received considerable attention and work but had not demonstrated economic potential. By June, 1937, Kerr Addison had outlined 600,000 tons

of proven ore and 400,000 tons probable. The indicated grade was relatively low but could not be forecast with the usual degree of certainty due to highly erratic mineralization.

A decision in 1937 to put the mine in production was made with considerable doubt that the estimated ore grade would be realized and, without the tax incentives, it is questionable if the same decision could have been justified. A plant of 500 tons daily capacity was built and put into operation in May 1938. The initial ore grade proved to be close to expectation.

Due in no small part to the cash flow generation indicated for the tax exempt period, the company was enabled financially to decide in 1939 to expand milling capacity to 1,200 tons per day. A further expansion to 2,100 tons was made at the end of the tax-free period when ore reserves had increased to 5 million tons. The mill was enlarged again in 1948 to 4,000 tons per day and from 1952 to 1960 an average of over 4,500 tons of ore per day was treated. The increase in ore reserves necessary to justify the higher treatment rates was accompanied by a trend toward higher ore grade, and Kerr Addison became Canada's largest gold mine in terms of production and ore reserves.

In 1960 it became evident that no ore would be found below the 4,500 ft. level, however, ore reserves at that time were sufficient for 16 years of operation.

For over 30 years this project, which, but for the tax incentives, might well have been abandoned, has made a very important contribution to the Canadian economy.

To the end of 1966 Kerr Addison has:

a)	Paid salaries and wages amounting to (current payroll 825 men - $4,000,000 annually)	$ 89,000,000
b)	Paid total taxes of	37,500,000
c)	Paid dividends to shareholders (84% of the shares are held by Canadian residents)	74,400,000
d)	Produced 8,244,000 ozs. gold with a value of	295,100,000

In addition, Kerr Addison plows back about $1 million annually in exploration. It brought Joutel Copper Mines into production early in 1967 and, with others, brought in the Icon Sullivan Joint Venture in May. It is presently undertaking underground development of a promising uranium property. It is very doubtful if any of these three new ventures would have proceeded without the present tax incentives.

Part V - Summary of Noranda's Progress

Noranda had strong resources during a period when tax incentives were such as to encourage taking risks in order to develop such resources in full. We submit that this company has developed as the planners would want such a company to develop. Beginning with nothing but a mining prospect, the company has developed into a major enterprise by any standard; its employment of people has expanded consistently; it has developed many remote areas and at the same time has integrated its operations from the production of metals to the manufacture and marketing of finished products; its manufacturing plants use all the copper that its mines produce.

Noranda is a Canadian company; out of approximately 33,750 shareholders, 91% are Canadian and hold over 89% of the outstanding shares.

Since 1948, when the present Income Tax Act became law, Noranda has earned -

Operating profits	$289,000,000
Dividends and interest received	162,000,000
Net loss on investments	(8,000,000)
	$443,000,000

and has provided for -

Exploration expenditures (written off)	$ 24,000,000
Taxes on income and mining taxes	118,000,000
Dividends to shareholders	197,000,000
	$339,000,000

In addition, Noranda has invested $66 million in capital assets and $160 million in investments in, and advances to, subsidiary and associated companies. Together with these companies, there has been expended a total of $293 million for capital assets and commitments or estimated costs of projects underway total $259 million. Included in the latter amount are substantial recent commitments to Brunswick Mining and Smelting and to Brenda Mines. The following comparative figures illustrate the growth of Noranda and its subsidiary companies (owned at least 50%).

	1948	1966
Number of employees	5,336	12,110
Annual payroll	$13,000,000	$66,000,000
Volume of supplies purchased	14,500,000	90,000,000

This progress has been possible in good measure because of the constructive tax rules applying to the mining industry, which have justified the risks involved in developing the mineral wealth of this country.

Noranda has contributed at least its fair share of taxes. Like other mines, it must pay provincial mining taxes on profits. While it may be argued that a mining tax is not a tax but a duty or royalty paid to acquire raw material, from any point of view it is revenue to society. If income and mining taxes are grouped, Noranda's average effective rate of tax has been as follows:

(Expressed in 000's dollars)

	Total income before tax provision	Taxable income before depletion	Depletion allowance	Fed. & Prov. income taxes	Mining taxes	Total income & mining taxes	Effective tax rate on taxable income before depletion
1962	$24,496	$16,714	$3,937	$6,629	$ 831	$ 7,460	44.6%
1963	24,996	15,775	3,555	6,334	873	7,207	45.7%
1964	41,920	13,068	2,499	5,447	924	6,371	48.8%
1965	43,355	22,422	6,560	8,100	2,486	10,586	47.2%
1966	52,840	24,707	5,607	9,907	3,685	13,592	55.0%
Five Year Average		$92,686				$45,216	48.8% Average

NOTE: The difference between Total Income and Taxable Income before Depletion is due to tax exempt dividend income and profit from investments as well as the differences between capital cost and other allowances claimed for tax purposes vs book write-offs.

The Carter Report recommends that mining taxes only be deductible from income as an expense before federal income taxes are calculated. Under the Commission's proposals, we estimate that Noranda's rate of tax for 1966 would have been 60% based on taxable income.

From the foregoing we trust that you will understand our opinion that the effects of the Carter proposals in respect of this industry will be far from neutral. Indeed it is our belief that they will injure a presently healthy situation and create a positive disincentive to any further growth.

We have attempted to keep this submission as brief as possible in view of our desire to be comprehensive. If, however, there are any omissions or uncertainties apparent to you or your staff, we would be pleased to submit or discuss such further or other information as may be required.

All of which is respectfully submitted by

NORANDA MINES LIMITED

Per R V Porritt
President

September, 1967.

APPENDIX "B"

Name of Company: NORANDA MINES LIMITED

Date of Hearing: January 29, 1970

INDEX OF DOCUMENTS ATTACHED

A—Conclusions of Tax Reform Proposals respecting Impact on Mining Industry.

B—Summary of Legislation and Principal Points of Brief, relating to:
- Mining Companies Generally
- Foreign Subsidiaries
- Inter-company Dividends
- Dividends paid to Shareholders
- Income Debentures

C—Financial Information Respecting

NORANDA MINES LIMITED.

Conclusions of Tax Reform Proposals Respecting Impact on Mining Industry

8.46 For special reasons there are a few types of investment where the after-tax return on investment would be affected in still other ways. Some companies for one reason or another distribute more in dividends than they pay in corporate income tax. If this continued they would not be able to provide the full amount of creditable tax with dividends. *The proposed termination of shareholders' depletion on dividends paid by companies in the mineral industry would of course reduce the immediate return on an investment in their shares, but if such dividends in fact reflect a return of capital the new provisions regarding the deduction of capital losses would be available. Implementation of the proposals for the corporate taxation of companies in the mineral industries would presumably be reflected after some years in the after-tax rate of return of those companies and their shareholders, particularly if the company does not carry on enough exploration or development work to earn a depletion allowance on its producing properties.* The after-tax return of investment in the ownership of buildings for rent, particularly by those intending to write off book losses on rentals against other income, would be reduced; this is a consequence of closing what has become a serious loophole in the present tax law.

8.47 Non-resident investors in Canada should not be substantially affected by the tax changes proposed in this paper except in particular categories. Withholding taxes on interest received by residents of countries with whom Canada now has tax treaties can be expected to remain the same, certainly on obligations issued before 1974 and probably by treaty on later issues. Withholding taxes on dividends would remain the same until 1974 and for residents of countries with which we have tax treaties they would probably continue at 15 per cent. However, one must expect higher rates to apply to interest, dividends and royalties paid to residents of tax-haven countries, subject to the qualifications noted in Chapter 6, and consequently the rate of return on Canadian investments made from or through such countries would decline. The general provisions affecting corporate income tax would affect the after-tax corporate income available for dividends to non-resident investors. *Non-resident investors in the mineral industries would be affected after some years by the elimination of the three-year exemption for new mines and by the need for corporations to "earn" their depletion allowances.* Non-resident investors would also be subject to capital gains taxes on the disposition of certain types of assets in Canada, notably real property, partnership interests, branch assets of business operations, the shares of closely-held Canadian corporations, and shares out of blocks larger than 25 per cent of widely-held Canadian corporations. *On the whole these changes affecting non-residents are not expected to cause any substantial reduction in foreign investment in Canada, although some decline must be expected in foreign investment in the mineral industries and in small closely-held corporations.*

8.48 *The changes proposed in the special tax rules applying to the mineral industry would have some effect in reducing the expected rate of return both from new mining projects and new oil and gas projects. The amount of the reduction would depend on the nature of the project and whether the owners expect to earn depletion to deduct from the income from the project. The over-all effect on the development of new mines cannot be forecast with any certainty; it would probably depend on general attitudes as well as on calculations. We do not expect it to be serious, though no doubt there would be some marginal projects abandoned or deferred in the*

next several years. The extra inducement offered in the mineral industry through the "earned depletion" and the immediate write-off of capital costs of new mines should continue to attract capital from Canadian sources and abroad, in competition with the resources and investment conditions offered in other countries. In addition, the ability to deduct exploration and development costs from other income, even for taxpayers not in the mineral or related industries, should help sustain the scale of exploration activities for mining deposits and oil and gas. All in all, the mineral industries would continue to be stimulated by some tax measures not offered to other industries, but not to as great a degree as under the present law.

8.49 *The general economic effects of these proposed tax changes would include* some moderate reduction in aggregate private saving and *probably some reduction in the capital expenditures of* closely-held corporations and *the mineral industries.* These would be offset by a small immediate increase in public revenues, and a rather larger increase after the early transitional years. These aggregate changes, however, could be taken into account in the determination of monetary and fiscal policy and could be offset in their general effects on total incomes, employment and prices. The most significant factor in the long term would be the moderate reduction in the rate of corporate saving by closely-held corporations; this may be offset by other trends, such as greater saving through pension funds and mutual funds.

8.50 The balance of international payments of Canada would be affected by a number of the proposed changes, but on the whole it should be modestly improved. There is no reason to expect any significant early effect on the current account of the balance of payments, including the net flows of interest and dividends. As noted in paragraph 8.47, foreign investors except in some special circumstances should not suffer any significant reduction in after-tax rates of return. *The special circumstances applying to investments in the mineral* industry and closely-held corporations *might lead to some reduction in the flow of direct investment in them.* The changes affecting the after-tax rates of return to Canadian investors in widely-held Canadian corporations do not appear likely to lead to a widespread buying out of the holdings of non-residents resulting in a large withdrawal of capital. On the other hand, we expect a substantial reduction in the net outflow of funds from Canada to purchase the shares of foreign corporations. The limits on the foreign investments of registered pension funds and retirement savings plans would safeguard against any major outflow through those tax-free channels. The tax changes should cause little if any change in the after-tax rate of return of non-resident investments in Canadian bonds or mortages or of Canadian investments in foreign bonds or mortgages. We do not expect that they would lead to any major change in the international flows of capital into interest-bearing securities. In total, therefore, we expect the result of these tax changes to be a modest reduction of the inflow of foreign equity capital into Canada and a somewhat larger reduction of the outflow of Canadian equity capital. The net effect on the balance of payments should be well within the range with which the normal offsetting and adjusting mechanisms can deal.

Principal Subject: Mining Companies

Present Tax Law

A. Cost of Mining Leases, Sect. 12-1-b, not deductible from income.

Tax Reform Proposals

5.27 Since 1962, the cost of acquiring oil rights or natural gas rights has been included in the definition of exploration and development expenses. Consequently these costs have been deductible for tax purposes within the limits of the rules relating to exploration and development expenses. It is proposed that this rule be retained, and that it be expanded to cover the costs of other mineral rights.

Principal Points of Brief

No comment in brief.

Principal Subject: Mining Companies

Present Tax Law

B. Proceeds of Sale of Mineral Leases, not included in income.

Tax Reform Proposals

5.28 Also since 1962, the proceeds of sale of oil rights and natural gas rights have been treated as taxable income. As part of the proposal to tax capital gains, this rule would also be extended to apply to all mineral rights. A special rule would be applied to the proceeds of the sale of rights which are held on the day this White Paper is published if the proceeds of the sale of those rights would not have been income for tax purposes under

the existing rules. This special, transitional rule is similar to that proposed in paragraph 5.8 with respect to existing goodwill; if the sale is in the first year of the new system, only 60 per cent of the proceeds would be taken into account; if in the second year, 65 per cent; the third year 70 per cent; and so on, increasing by 5 per cent each year until all of the proceeds are taken into income if the sale is in the ninth or a subsequent year. Since the cost of these rights would henceforth be deductible for tax purposes, prices should rise and this system should produce a fair after-tax return to the present owners.

Principal Points of Brief

No comment in brief.

Principal Subject: Mining Companies

Present Tax Law

C. Exploration Prospecting and Development Expenses, Sect. 83A-3b, deductible from income.

Tax Reform Proposals

5.25 The present rules concerning exploration and development costs accomplish the objective set out in the preceding paragraph: the costs of mineral exploration and development can be deducted for tax purposes early enough so that taxes will be applied only when it is clear that a project will be profitable. Under these rules, a corporation which has as its principal business either mining, the production of oil, or certain allied activities (refining and/or distributing petroleum or petroleum products, fabricating metals or operating pipelines), may deduct Canadian exploration and development costs as they are incurred. If these costs exceed the corporation's income, then it may deduct the balance of the costs in the first subsequent year in which it has enough income.

Principal Points of Brief

See page 4 of brief. Note forecast on page 4 that: (a) exploration in Canada will decline; (b) foreign companies will also reduce expenditure; (c) there will be fewer new mines.

Principal Subject: Mining Companies

Present Tax Law

C. Exploration Prospecting and Development Expenses, Sect. 83A-3b, deductible from income.

Tax Reform Proposals

5.26 Other taxpayers may also deduct exploration and development costs as they are incurred, but if they do not meet the principal business test mentioned above, they may deduct them only from income from mineral properties. This rule has guaranteed that tax was not paid until these costs were recovered, but it has meant that taxpayers who were unsuccessful in their mineral projects have suffered losses that were not deductible for tax purposes. To cure this defect, it is proposed that taxpayers who fail to meet the principal business test be entitled to put their future exploration and development expenses in an asset class and to deduct annually part or all of their accumulated undeducted expenses up to a maximum of the greater of two amounts:

(1) their income from mineral properties before any deduction in respect of exploration and development expenses,

or

(2) 20 per cent of the net book value of the class.

For this purpose, income from mineral properties would include producing profits, royalties received, and the proceeds of the sale of mineral rights.

Principal Subject: Mining Companies

Present Tax Law

D. Capital Cost Allowances, Class 10 of Schedule B 30% Capital Cost Allowance.

Tax Reform Proposals

5.29 In addition to their exploration and development expenditures, mining corporations spend large sums of money on mining machinery and buildings before they know whether their new mine will be profitable. In order to recognize this risk, the government proposes to put depreciable assets of this type acquired for production from a particular new mine in a separate asset class and to permit the taxpayer to write them off for tax purposes just as fast as he has enough income from the new mine to absorb the charge. The assets concerned are those described in paragraphs (g) and (k) of class 10, which read as follows:

"(g) a building acquired for purpose of gaining or producing income from a mine (except an office building that is not situated on the mine property and a refinery)

"(k) mining machinery and equipment acquired for the purpose of gaining or producing income from a mine."

5.30 This provision would not replace the existing right to deduct 30 per cent of the net book value of assets in this class: it would supplement it. If th new mine produces sufficient profit to absorb a deduction of more than 30 per cent, the taxpayer could make that deduction. If it does not, he could nevertheless deduct up to 30 per cent if he chooses, thereby either reducing other income or producing a business loss which could be offset against income in other years.

Principal Points of Brief

No comment in brief.

Principal Subject: Mining Companies

Present Tax Law

E. Three Year Tax Holiday, Section 83-5, income for three years after commencing operations is exempt from tax.

Tax Reform Proposals

5.31 Once the provisions concerning exploration and development costs, the costs of acquiring mineral rights, and the costs of mining machinery and buildings are in place, taxpayers can be pretty well assured that they would not be taxed on mining ventures until after they recover their investment. Having provided that assurance, the government proposes to phase out the present three-year exemption for new mines.

5.35 The present three-year exemption would continue to apply until December 31, 1973, in accordance with the announcement made by the then Minister of Finance in May, 1967. New mines which have come into production in commercial quantities before the publication of this White Paper would be eligible for the exemption but would not be able to take advantage of the new proposal concerning fast write-off. New mines which come into production after the publication of this White Paper but before January 1, 1974 would be entitled to elect to take advantage of either incentive but not both. Specifically, they would be entitled to claim exemption of the profits earned either in the first three years of operation or in the period remaining to January 1, 1974, if that is shorter. At the end of the exempt period they would be entitled to the fast write-off of the capital cost of their mine assets, but only if they reduce the book value of those assets by the full amount of their exempt profits.

Principal Points of Brief

See page 7 of brief. Note recommendation on page 7 that three year period be restricted to period required to recover initial capital.

Principal Subject: Mining Companies

Present Tax Law

F. Depletion—Operators, Section 1201 of Regulations; 33⅓% depletion allowance based on net mineral profits.

Tax Reform Proposals

5.36 At present, the act provides that operators of mineral resources, and this phrase includes oil and gas wells, are entitled to reduce their taxable income by claiming depletion allowances. For the most part these depletion allowances are calculated as a percentage of the profits derived from production from the mineral resource, and the usual percentage is 33⅓ per cent. Special rates of depletion are provided for gold and for coal.

Principal Points of Brief

Page 2 and 7 of brief. Note recommendation on page 7 that base for depletion be extended to include all expenditures for exploration and development plus fixed assets and expenditures on existing mining operations.

Principal Subject: Mining Companies

Present Tax Law

F. Depletion—Operators, Section 1201 of Regulations; 33⅓% depletion allowance based on net mineral profits.

Tax Reform Proposals

5.40 The government believes that both of these inefficiencies can be substantially reduced if depletion allowances are more directly related to the activities which it is desired to affect. Consequently it is proposed that, after a suitable transitional period in respect of mineral rights held by the taxpayer on the day this White Paper is published, depletion allowances would have to be "earned". The existing maximums would continue to apply—that is, generally no more than ⅓ of production profits—but a taxpayer could only deduct these maximums, or any amount, if he spends enough on exploration for or development of mineral deposits in

Canada or on those fixed assets described in paragraph 5.29 that are acquired for the exploitation of a new Canadian mine. The formula proposed is that for every $3 of eligible expenditures made after this White Paper is published a taxpayer would earn the right to $1 of depletion allowance. If his profits that year are not sufficient to permit him to deduct the amount earned, he could carry the undeducted amount over the subsequent years. The cost of acquiring mineral rights would not be an eligible expenditure for this purpose.

Principal Subject: Mining Companies

Present Tax law

F. Depletion—Operators, Section 1201 of Regulations; 33⅓% depletion allowance based on net mineral profits.

Tax Reform Proposals

5.41 Under the proposed system, a taxpayer could run out of depletion allowances unless he continues to explore for, and/or develop, Canadian minerals. Once the system is fully effective, a taxpayer's allowances would end when his profits before "eligible expenditures" exceed twice the amount of those expenditures. Consider the following example:

Profits before eligible expenditures	$ 6,003
Deduct eligible expenditures	3,000
	3,003
Maximum depletion $1,001 (⅓ of $3,003)	
Earned depletion (⅓ of $3,000)	1,000
Taxable income	$ 2,003

5.42 The system would not become fully effective immediately. The government proposes that for the first five years of the new system taxpayers be entitled to depletion allowances in respect of production profits from properties they now own without having to "earn" them. This period, combined with the entitlements to the earned allowances that taxpayers would be able to accumulate between the publication of this White Paper and the end of 1975, should enable the mineral industries to make a smooth transition to the new system.

Principal Subject: Mining Companies

Present Tax Law

G. Depletion—Non-Operators; Section 1202 of Regulations; 25 percent depletion allowance based on proceeds, rents or royalties.

Tax Reform Proposals

5.43 Under the present legislation a depletion allowance of 25 per cent may be deducted by non-operators from their income from mineral properties. This provision applies principally to the holders of royalties. The concession sought to recognize that royalties might well in part be a return of capital. This fact would under the present proposals be more accurately recognized by the proposed rules concerning the amortization of the cost of acquiring mineral rights. Therefore it is proposed that the percentage depletion at present available to non-operators be repealed.

Principal Points of Brief

No comment in brief.

Principal Subject: Mining Companies

Present Tax Law

H. Depletion allowance on dividends; Section 1300 of Regulations; Allowance of 10 per cent, 15 per cent or 20 per cent of dividends.

Tax Reform Proposals

5.44 Also, under the present legislation a depletion allowance of 10 per cent, 15 per cent or 20 per cent may be deducted from dividends received from a mining or oil company, the percentage depending upon the proportion of the income of the corporation which is derived from production. This concession was meant to recognize that the corporation might in fact be paying dividends out of capital. Under the new system this fact would be more accurately recognized by the deduction granted to taxpayers for losses realized on shares which they have held. Therefore it is proposed that shareholders depletion be removed.

Principal Points of Brief

See page 6 of brief. Note comment on page 6 that benefits to shareholders of mining shares would be less than to holders of industrial shares.

Present Tax Law

I. Provincial Income Taxes on Mining Profits; Section 11-1-p of act and Part VII of Regulations.

Tax Reform Proposals

No proposal.

Principal Points of Brief

Pages 3 and 7 of brief. Note recommendation on page 7 that provincial mining

taxes be deductible from federal income taxes.

Principal Subject: Foreign Subsidiaries

Present Tax Law

Foreign Subsidiaries; Section 28-1; Dividends from foreign subsidiaries are free of Canadian tax, as long as parent in Canada owns 25 per cent or more of voting stock of subsidiary.

Tax Reform Proposals

6.15 The government has concluded that neither of these systems is either "right" or "wrong". It proposes to continue in a restricted form the present exemption of dividends received by a Canadian corporation from a controlled foreign corporation. For this purpose, the Canadian corporation would be assumed to control the foreign corporation if it owns 25 per cent or more of the voting shares of the foreign corporation. The first restriction proposed is that the exemption privilege would be extended only to dividends from those countries with which we have concluded bilateral tax treaties. A second is that the effect of the exemption would be eliminated for certain types of diverted income by the proposals described below under the heading "Passive Income of Controlled Foreign Corporations." These restrictions are necessary to frustrate efforts to use the dividend exemption to reduce artificially the tax burden on tax-haven income.

6.17 A dividend from a Canadian-controlled foreign corporation not protected by tax treaty would be subject to a tax-credit regime. The Canadian corporation would be allowed a credit for the foreign withholding taxes imposed on the dividend and for any foreign corporate tax imposed on the underlying business profits from which the dividend was paid. This would reduce or eliminate taxes due on the dividend, which taxes would be computed on the dividend plus the tax for which credit was available.

Principal Points of Brief

Page 6 of brief. Comment left to other submissions.

Principal Subject: Foreign Subsidiaries

Present Tax Law

Foreign Subsidiaries; Section 28-1; Dividends from foreign subsidiaries are free of Canadian tax, as long as parent in Canada owns 25 per cent or more of voting stock of subsidiary.

Tax Reform Proposals

6.21 To counter this type of tax-haven abuse, the United States now provides that when such income is channelled to a controlled foreign corporation, the U.S. controlling shareholders shall be taxed on a current basis whether or not the income is distributed to them. U.S. taxes are levied in the year in which the profits are earned rather than postponed until the profits are returned home. The government proposes to introduce provisions patterned generally on those in the United States. This proposal involves complicated and difficult law, but the problem is serious and defies easy solution.

Principal Subject: Inter-Company Dividends

Present Tax Law

Inter-Company Dividends; Section 28-1; these dividends pass free of tax between companies.

Tax Reform Proposals

4.57 A widely-held Canadian corporation receiving a dividend from a closely-held Canadian corporation would be taxed on the dividend in the same way that it is taxed on other income. Specifically, the corporation receiving a dividend of $100 from a closely-held Canadian corporation would take into its income for tax purposes $200 and claim as a deduction from the corporate tax it would otherwise pay the $100 corporation tax paid by the first corporation. In effect the dividend would have been received tax-free in this situation. However, if the corporation that pays the dividend has not paid sufficient corporation tax to Canadian governments to cover the dividend, the receiving corporation would have some net tax to pay.

4.58 When the receiving corporation pays a dividend to its shareholders it would instruct them to add to the dividend for purposes of the tax calculation only half of the corporation tax levied on it. The schedule set out below illustrates this procedure. The effect is that shareholders of Canadian public corporations receive credit for half, and only for half, of the corporation tax paid on the profits from which their corporation pays its dividends. This is true whether the profits are earned in a subsidiary corporation or in the public corporation itself.

Principal Points of Brief

See Pages 5, 6 and 8 of Brief. Note forecast made on page 6 that subsidiaries may be sold to foreign interests.

Note recommendation on page 8 that dividends continue to pass free of tax through Canadian Corporations.

Principal Subject: Inter-Company Dividends

Present Tax Law

Inter-Company Dividends; Section 28-1; These dividends pass free of tax between companies.

Tax Reform Proposals

4.59 Special rules are needed to cover the case of a public corporation which receives a dividend from another public corporation. If the dividend were taxable at normal corporate rates, the effect would be to collect more corporate tax in those instances where there are intercorporate holdings than in those instances where the individual shareholder holds his share in the operating corporation in his own name. To overcome this shortcoming it is proposed that a special tax rate be applied to the dividends received by Canadian public corporations from other Canadian public corporations. The rate would be $33\frac{1}{3}$ per cent so that this type of intercorporate dividend would be tax-free provided the corporation paying the dividend had paid sufficient Canadian corporate tax to cover the dividend. This special rate would also be applied to capital gains realized by one Canadian public corporation on the sale of shares in another Canadian public corporation. Finally, the loss suffered by one Canadian public corporation on the sale of a share in another Canadian public corporation would reduce tax only at this special rate. The effect of this rate on dividends passing through an intercorporate chain is illustrated in the following schedule:

Principal Subject: Dividends paid to Shareholders

Present Tax Law

Dividend Income; Section 6-1-a and 38-1: Dividends are taxed as income, less a 20% Canadian Dividend credit.

Tax Reform Proposals

1.42 Widely-held corporations are usually larger businesses where the link between shareholders and management is tenuous. Such corporations are themselves important economic entities. Their products or services are usually sold in competition with other large corporations, where prices yield an adequate return after paying corporate tax. One half the corporate income tax paid by such corporations would be regarded as a prepayment of individual tax for individual Canadian resident shareholders, but the other half would not be linked in this way. Shareholders receiving dividends from profits taxed under the new plan would be liable for tax on the dividend plus an amount of "creditable tax" equal to half the dividend and would be given credit for that amount of tax. This system would be roughly equivalent to the present dividend tax credit for taxpayers in the 50-per-cent tax bracket and would be more favorable for those in lower tax brackets. It would thus provide a powerul incentive for investment by Canadians in Canadian corporations.

Principal Points of Brief

See page 8 of brief. Note recommendation that it be assumed that full corporate tax has been paid by a mining company.

Principal Subject: Dividends paid to Shareholders

Present Tax Law

Dividend Income; Section 6-1-a and 38-1; Dividends are taxed as income, less a 20 per cent Canadian Dividend credit.

Tax Reform Proposals

4.36 However, the government does want to reform the dividend tax credit. It proposes to replace the existing credit with a system giving Canadian shareholders credit for one-half the Canadian corporation tax paid by the corporation on the profits from which the dividend is paid.

4.37 Again, an example may help to explain how the system would work. A Canadian public corporation with profits of $1,000,000 would pay a tax of $500,000, leaving $500,000 available for distribution to the shareholders. If it pays the $500,000 out in dividends, it would instruct the shareholders to report $750,000 as their income for tax purposes and to claim credit for $250,000 of the $500,000 of corporate tax paid by the corporation. A shareholer who receives a dividend of $100 would therefore report $150 as the income from the corporation and would show on his return that $50 tax had been paid by the

corporation, $40 federal and $10 provincial. If his marginal tax rate is 40 per cent, the tax on the dividend would be $60 and he would owe the governments $10. If his marginal tax rate is less than one-third he would be entitled to a refund. As in the case of closely-held corporations, this procedure would be applied both to cash dividends and to stock dividends so that the process should not by itself force corporations to pay out in cash a higher proportion of their profits than they would under the present system. Also, as in the case of closely-held corporations, the credit would only be given if the corporation declares these dividends within the time limits prescribed.

Principal Subject: Income Debentures

Present Tax Law

Section 12-1-f; Interest paid on Income Debentures considered to be dividend payment not deductible. Section 8-3; Interest received from Income Debentures considered to be dividend income.

Tax Reform Proposals

No proposals.

Principal Points of Brief

See page 6 of brief. Left to others to comment.

NORANDA MINES LIMITED

FINANCIAL INFORMATION

	Pre-tax Earnings	Taxable Income	Taxes Paid	Taxes payable under Proposed Reforms	Increase in Taxes under Proposals	Expenditures on Exploration and Development	Capital Expenditures	Dividends Paid to Outside Shareholders
	($000s)							
Mining Companies only								
1968	87,163	33,871	24,862	36,250	11,388	15,629	25,315	24,795
1967	83,294	31,852	22,543	41,016	18,473	14,806	21,424	22,409
1966	73,960	26,904	19,480	25,745	6,265	16,619	11,496	22,282
1965	57,433	21,840	24,491	23,244	8,753	8,597	6,794	20,401
			81,376	126,255	44,879			
Manufacturing and Other Companies only								
1968	10,493	5,755	5,620	2,651	−2,969	—	13,257	Dividends paid as shown above
1967	13,679	10,721	5,475	4,616	— 859	—	18,104	
1966	13,666	12,504	6,218	5,619	— 599	—	21,262	
1965	13,371	7,473	3,796	4,004	208	—	8,639	
			21,109	16,890	−4,219			

NORANDA MINES LIMITED
as a Corporation

FINANCIAL INFORMATION

	Pre-tax Earnings	Taxable Income	Taxes Paid			Taxes payable under proposed Reforms	Increase in taxes under Proposals	Expenditures on Explora- tion and Development	Capital Expenditures	Dividends paid to outside shareholders
			Income	Mining	Total					
	($000s)									
1968	22,864	24,494	12,970	4,778	17,748	25,533	7,785	5,447	2,613	24,478
1967	61,759	24,310	12,593	4,040	16,623	31,889	15,266	5,299	4,082	22,082
1966	52,840	19,099	9,893	3,706	13,599	17,714	4,115	4,956	4,334	21,961
1965	43,355	15,862	8,272	2,485	10,757	16,281	5,524	4,828	1,398	20,110
					58,727	91,417	32,690			

Second Session—Twenty-eighth Parliament

1969-70

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE
ON
BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 7

WEDNESDAY, FEBRUARY 4th, 1970

Second Proceedings on the Government White Paper,
intituled:
"PROPOSALS FOR TAX REFORM".

APPENDICES:

"A"—Summary of: "Proposals for Tax Reform".
"B"—Special Study No. 1—Proposals not immediately effective.
"C"—Special Study No. 2—Loopholes and tax avoidance.
"D"—Special Study No. 3—Comparison of proposed and present tax rates.

21288—1

THE STANDING SENATE COMMITTEE ON

BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aseltine	Desruisseaux	Kinley
Beaubien	Everett	Lang
Benidickson	Gélinas	Leonard
Blois	Giguère	Macnaughton
Burchill	Grosart	Molson
Carter	Haig	Phillips (*Rigaud*)
Choquette	Hayden	Walker
Connolly (*Ottawa West*)	Hays	Welch
Cook	Hollett	White
Croll	Isnor	Willis—(30)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

"With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intituled: "Proposals for Tax Reform", prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

"With leave of the Senate,

The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowerd to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

ROBERT FORTIER,
Clerk of the Senate.

21288—1½

MINUTES OF PROCEEDINGS

Wednesday, February 4th, 1970.
(9)

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to further consider:

Government White Paper entitled:
"Proposals for Tax Reform".

Present: The Honourable Senators Hayden, (*Chairman*), Beaubien, Benidickson, Blois, Burchill, Carter, Connolly, (*Ottawa West*), Cook, Croll, Desruisseaux, Everett, Flynn, Gélinas, Giguère, Haig, Hays, Hollett, Isnor, Kinley, Lang, Leonard, Macnaughton, Molson and Phillips (*Rigaud*)—(24).

Present, but not of the Committee: The Honourable Senators Aird, Laird and Urquhart—(3).

In attendance:

Mr. Arthur W. Gilmour,
Senior Advisor.

Mr. R. B. Breton,
Executive Secretary.

A general discussion took place during which Mr. Gilmour undertook to supply the Committee with the results of certain studies to be made by him on request of certain members of the Committee.

Mr. Gilmour then explained to the Committee the following documents:

1. Summary of: "Proposals for Tax Reform".
2. Summary of Proposals that would not be effective immediately.
3. Reference to loopholes and tax avoidance.
4. Comparison of present tax rates with proposed tax rates.

Ordered:—That the above mentioned documents be printed as appendices "A", "B", "C" and "D" to these proceedings.

At 12:00 Noon the Committee adjourned to the call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Wednesday, February 4, 1970

Ottawa, Ontario

The Standing Senate Committee on Banking, Trade and Commerce met this day at 9 a.m. to give further consideration to the White Paper entitled "Proposals for Tax Reform".

Senator Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: Honourable senators, before we get down to the business of the meeting, which is to hear some statements on some of the important points in the White Paper from Mr. Gilmour, Senator Phillips (Rigaud) has a suggestion to make that I think is worthwhile, and one which may be we could adopt.

Senator Phillips (Rigaud): Thank you very much, Mr. Chairman. I was thinking, honourable senators, that it would be desirable to get from our technical guiding staff some information on three points. I think this might be helpful to us as we study our problems and listen to further representations which will begin to crowd on us very shortly.

First I would make this request to Mr. Gilmour and his associates. Without at this stage prejudging whether a capital gains tax is desirable or not—because obviously we are in the initial stages of listening, and studying in due course—I think it would be desirable for Mr. Gilmour and his associates to let us have a summary of the present tax treatment of capital gains in the United States, coupled with some indication of their initial approach, the present law and the reasons for the revision. Such summary should not be too cumbersome, because some members of the committee are not lawyers and obviously we get over-instructed. I think it could be left to Mr. Gilmour to let us have a memorandum on that subject. I might say that personally I have a feeling that sooner or later we probably will be living with a capital gains tax, but tentatively I am of the opinion that the approach at this stage is a little cumbersome, and I think the experience of our neighbour to the south will be helpful.

The second request I should like to make is this. It is my impression that the dividend tax credit treatment originally introduced some years back in the United Kingdom did not fall quite flat on its face put pretty close to it. Somewhere in 1955 or 1956 there was some revision, I think, I am not sure about my years, on this whole question of dividend tax treatment.

I think it would be helpful there, too, if we had a short memorandum dealing with that subject matter. Here also I wish to express my personal views on a tentative basis. I think the dividend tax approach heretofore followed and necessarily modified in the new form would be helpful, nevertheless information on the United Kingdom experience would be helpful.

Thirdly, I think honourable senators would be very much helped if we had some information with respect to the subject matter of offshore companies coming under the so-called heading of "loopholes"—the loophole approach. I think our chairman himself has guided us on that point. There is no such thing as loophole offshore companies if you obey the law. The thing is to avoid the type of offshore companies to which the administration is objecting.

Here also it is my information that our neighbour to the south has had considerable experience on the whole question of offshore companies and I am told that, as a result of a recent international conference at which—what shall I say—so-called tax experts were present, the view was expressed by United States officials that they are not all happy about the legislation on offshore companies and something would have to be done about it. I think a summary of the present law in the United States on the treatment of offshore companies, with some indication of the problems that our neighbour to the south is having there; and, if available, some informa-

tion also on how they propose to deal with it, would be helpful to us when, sooner or later, we will be dealing in the details, listening to representations and, in due course, arriving at conclusions.

Those are my three submissions.

Senator Connolly (Ottawa West): May I ask the senator, on his first point, with respect to capital gains, if the question of the revenue involved might be examined a bit. The White Paper now proposes that capital gains be put in on top of normal income. No doubt, in the high tax levels, the revenue would be considerably more. Does he envisage that Mr. Gilmour might indicate an estimate of the revenue consequences of using the White Paper method or using the capital gains tax method?

Senator Phillips (Rigaud): That was implied, or at least I meant it to be implied in my request.

Senator Connolly (Ottawa West): I suppose that would involve some assumptions, number one being what the level of capital gains tax might be. Perhaps it could be examined at various levels from the point of view of income?

The Chairman: You can take the level in the United States. Then you have a considerable factor as to when it becomes a capital gain. In the United States, if you held for longer than six months, the capital gain rate applies. Otherwise, the income tax rate applies. And what rate you use depends on how much income tax revenue you are looking for. You might have to try a variety of rates.

Senator Connolly (Ottawa West): This is what I am afraid of, and I would not like it to be too complicated. At the same time, I think it would be helpful.

The Chairman: It may be that you could translate the expected revenue from the capital gains tax in the form in which it appears in the White Paper, and try to translate that into percentage.

Senator Phillips (Rigaud): Senator Croll has indicated to me that I overlooked the fact that we have a capital gains tax in the United Kingdom. In dealing with that subject matter of the method of treatment in the United States, we might with some value deal with the subject matter of how the subject is treated in the United Kingdom.

Senator Molson: That was my first point, really. The other was that in the American capital gains tax there is the principle of the quick gain and the long-term one—which I have always thought had considerable validity, in that it probably results in a completely different approach, or frequently in a different approach, to any transaction.

The Chairman: You mean, one is a fast buck?

Senator Molson: One is probably deliberately for a fast buck, and in the other it could possibly be that, in the course of doing something else, there arises a capital gain—which is still desirable.

The Chairman: There are two different intentions.

Senator Molson: There are two different intentions.

Senator Macnaughton: With regard to point number 3 of Senator Phillips' suggestion, I presume it is implied, when speaking of offshore companies, but I would ask, if we could have a slight reference to the Canadian picture, too. The two go together.

The Chairman: Is there any other comment on what Senator Phillips has suggested? If not, this is an instruction, then, from the committee to Mr. Gilmour to cause these studies to be made.

Hon. Senators: Agreed.

The Chairman: We have had indications and requests for different dates for meetings. They seem to occur principally in March and April. As soon as we get them tabulated, we will report to the committee.

I thought we would have Mr. Gilmour give what clarification would appear to be desirable in connection with the important points which are the subject matter of the White Paper. He has prepared some memoranda. We are not trying to overload you with paper. Every bit of paper that you have documents some important aspect of the White Paper. It may encompass a lot of reading, but if you wish to be knowledgeable it has an important place. It may well be that, with the explanations that Mr. Gilmour will give today, what you have before you will become more meaningful.

Senator Benidickson: I am very pleased to have received some of the technical and very special documents from Mr. Gilmour's

office. The material that perhaps Mr. Gilmour intends to discuss this morning arrived at our desks only about five o'clock yesterday. And we had an evening sitting. I did intend to read it. This material is good and shows the background of good staff. We have relied on you as chairman very much for an explanation of what is available.

The Chairman: Our plan is to get the material to you earlier than this arrived, but the decision on how we should approach this meeting today, and what should be prepared, was not made in time to get it to you any earlier. We will do better in the future.

Senator Benidickson: I am quite complacent about that, but I just want to say that you cannot do this overnight.

The Chairman: You would be surprised what Mr. Gilmour can turn up in the way of research pretty quickly.

Mr. Benidickson: I look forward to his testimony this morning.

Senator Carter: When we had Mr. Bryce and Mr. Brown before us, I got the impression that they had not done very much homework on the impact of the proposals. They took this pretty well for granted. Are we initiating any studies of our own, to make up for that?

The Chairman: Yes.

Senator Carter: There seemed to be a wide discrepancy in the total yield of these tax proposals. Quebec says it is over $600 million, Ontario says it is over $1 billion. Have you any facilities to check this?

The Chairman: This is one of the points I expect Mr. Gilmour will touch on today. Now, Mr. Gilmour, the floor is yours.

Mr. Arthur Gilmour, Special Tax Adviser: Thank you, Mr. Chairman. Honourable senators, I have put before you a mass of documents, but not to confuse you. These were prepared in a bit of a rush. They were not delivered to you last evening: they came with me on the 7 a.m. plane this morning. As our chairman says, we will do better.

I would like to introduce my loyal assistant, Mr. Philip Nutt, who is "standing on his head" at the moment. I have had the good fortune to have him as my associate and right-hand man ever since we were at McGill together, back in 1933. This dates me pretty well. Of course, Mr. Nutt knows all the answers in regard to income tax. I just say them in an assured tone of voice. He is the gentleman who has done most of this research.

Gentlemen, this morning I have put before you this ominous looking black book. When I started to study the White Paper I had the greatest difficulty in reading it and understanding it, therefore, being a bookkeeper at heart I took the subject matter of the White Paper and assembled it under certain arbitrary headings. There is nothing significant about these headings; they just appeal to me. As an example, the top heading is Statutory Exemptions and this is found on page 1. I have simply reproduced every paragraph of the White Paper that deals with personal exemptions. The White Paper jumps all over the place and it pretty well defies any man to read it 20 odd times as I have and still be able to assimilate it. I, therefore, took the liberty of putting before you an attempted summary of all the parts that deal with the subject matter that I have chosen under different headings.

The Chairman: Could you describe this as being an integration of the White Paper by subject matter?

Mr. Gilmour: Yes. It is merely the White Paper. I think you may find it very convenient as I have, when we come to the discussion of, say, capital gains. On page 8 I have assembled every paragraph that refers to capital gains and with your permission, in a few minutes, I will be referring to this.

We have also placed before you three special studies. These have emanated partly from the suggestion of our chairman and partly at the suggestion of Senator Phillips (Rigaud). Study No. 1 was suggested by the chairman and this study was delivered to you last evening. It shows a summary of the White Paper proposals that are not effective immediately, but rather have a transitional section or period of time. It is interesting to see those sections that will come into effect over a period of three, four and five years. Beyond that, I do not propose to say anything about it. If any of you wish to read it, it will be of interest.

Study No. 2 is somewhat interesting. In this heading it indicates the parts of the White Paper that refer to tax havens, tax evasion, loopholes and all of those nasty things that the tax collector frowns upon, and they are summarized in this study No. 2.

Senator Benidickson: Is that just looking to the past or the White Paper?

Mr. Gilmour: To the White Paper. I would suggest that perhaps a quiet review of these would give you a pretty good indication of some of the thinking of our devoted civil servants who drafted this White Paper. There is very much of the mentality of the frustrated tax collector and in case you think I am being critical, I should point out that I spent 13 years of my professional life as a tax collector and the last 20 as a tax adviser, so that covers my range of professional activities.

The Chairman: I do not know whether he would agree that he has had the best of both worlds, but I should think he has been in both worlds.

Senator Phillips (Rigaud): Incidentally, in the 13 years he was very troublesome to me as a practising lawyer.

Mr. Gilmour: Senator Phillips and I became old friends during those 13 years.

This study No. 2 is merely for background reading, if you gentlemen should ever have the time to look at it. I will refer to study No. 3 in some detail in a few moments. This is a comparison of the present federal and provincial income taxes as they exist today and the proposed rates as set out in the White Paper and the proposed provincial income taxes. I would defy any man to understand the figures that are set out in this White Paper. Consequently, while I did not use our own computer to make this up I did use my associate's brain.

We have before us what I feel is going to prove to you a most valuable contrast in our old tax rates and our new ones. I feel, gentlemen, that it will be of assistance, after reading in the Montreal *Gazette* this morning of the fears expressed in Nova Scotia and elsewhere. When we discuss it shortly it will give you and myself an excellent understanding of the legitimate fears of the provinces and I suppose the legitimate fears of us as Canadian taxpayers. From time to time there will be more of these special studies. Senator Phillips has asked for three, which will take a little time because I will have to contact our partners in the United Kingdom and the United States. I hope to be able to produce something useful to you.

Honourable senators, after those comments, with your permission, in the time at our disposal this morning, I should like to refer to some of the more controversial portions of the White Paper.

Senator Molson: Before you continue, Mr. Gilmour, may I just ask you if every clause in the White Paper is referred to somewhere in the Black Book proposal for tax reform, which you have circulated this morning?

Mr. Gilmour: Yes, senator, all the taxing clauses are contained in the Black Book. To use an unparliamentary word, I left out the "bumpf". I have also left out the pious suggestions to the provincial governments.

Senator Molson: And the pious hopes.

Senator Pearson: And what meaning do you give to the word "bumpf"?

Mr. Gilmour: Bumpf is unnecessary verbiage. I have sought to give you the guts of the White Paper here and to give you the cross-references so that you could satisfy yourselves that I have not altered anything.

One last word, honourable senators: I have sought this morning to talk to you in as impartial a way as I can, because I realize this is a judicial body; and, although I have very strong feelings myself, I will seek to conceal these so that we may discuss these matters in an impartial way. Then you will make your own decisions in due course.

Turning now to our agenda for this morning, which is the blue folder marked "Discussion of Principal Points of the White Paper," you will remember that a week ago when we had Mr. Bryce with us we looked at the summary of the taxes to be collected and the taxes to be reduced. You may remember that we found that there were certain increased exemptions offered—$400 to a single taxpayer; $800 to a married taxpayer. The estimated cost of giving those exemptions to Canadian taxpayers was $1,000 million, or $1 billion. Then there is also given to every taxpayer who is employed an allowance for expenses connected with his employment. That allowance is $150. That allowance for expenses is estimated to cost the country $235 million.

We have spelled that out here under statutory exemptions, for those who may want to look. I don't propose to waste your time this morning, but I have put the reference to pages 1 and 39 of the Black Book, and that in turn refers to certain paragraphs of the White Paper, 1.23, 2.4 and 1.32.

These paragraphs condensed mean that every taxpayer in Canada, starting from the lowest office boy right through to probably

the wealthiest man in Canada, is given an increased deduction. Whereas an unmarried taxpayer had a $1,000 personal exemption and had $100 allowance for medical and charitable donations, giving him $1,100 in total, and a married man had a total of $2,100 in exemptions—and I am forgetting about dependants here because they are not relevant, those exemptions are now increased by a further $400 for the unmarried man and $800 for the married man, plus $150 employment expenses in both cases.

That means that if any of you senators are still in the position of being officers of corporations, if that be permitted to you—not directors because a director is not an employee—but if you are an officer of the largest corporation and your income is in the top bracket, nonetheless you may solemnly claim this $150 additional amount and, of course, either the $400 additional, if you are single, or the $800, if you are married and entitled to the full marital deduction.

This sweep across the board of these exemptions is estimated to cost the country $1 billion to give all of us this increased exemption, and another $235 million to give all of us an arbitrary deduction for expenses connected with our employment. I presume there is no accounting for this arbitrary deduction for expenses. So we have, in effect, a personal exemption of $1,400 in the case of a single man and $2,800 in the case of a married man plus, in both cases, the donation allowance of $100 together with the employment expense of $150.

Now, the reason for these increased exemptions right across the board is not clear to me. The reason may come out in the hearings in the future, but we have the fact that there is this across-the-board exemption to people like ourselves who do not need it. Of course this has the effect of removing 750,000 taxpayers in the lowest of the brackets.

Mr. Brown last week told us that the cost of removing 750,000 taxpayers from the tax roll would be between $30 million and $35 million. He offered to give us position papers on that computation, and I am looking forward to seeing them. But then, apparently, the cost of giving the rest of us this increased exemption is $1 billion less the $35 million. Consequently, there will be before us the question of the wisdom of that increased deduction to all of us who don't need it, particularly when we turn to the next subject, which is the increase in the statutory rates of tax that will be facing us in the future.

The new schedule of taxes is referred to on page 54 of this black book, and there are there set out several of the paragraphs that are contained in the White Paper. It is estimated that these new schedules will extract from Canadian taxpayers, excluding the 750,000, a sum of $1,255 million which, you will notice, compares rather aptly with the deductions to give us the increased exemptions. The cost to the country of the exemptions was $1 billion and $235 million for the employment expense. On the other side of the coin we are to collect $1,255 million. Obviously, it is going to be collected from a vastly different type of person and, with your permission, if I could turn to this Special Study No. 3, it leads off:

> This study seeks to compare the present net federal taxes and provincial taxes computed at 28 per cent of the basic federal tax with the proposed federal taxes and provincial taxes computed at 28 per cent of the proposed federal taxes.
>
> While both schedules are based on taxable income, it should be realized that taxable income on which the proposed taxes will be based will be generally $550 and $950 less than at present.

Then I have quoted the paragraphs of the White paper that refer to this.

Senator Phillips (Rigaud): This is $400 plus $150 for unmarried, and so on?

Mr. Gilmour: Yes.

The Chairman: The base will be less because the exemptions are more.

Mr. Gilmour: Quite.

If I could leave for the moment page 2 of this study and ask you to look at the comparative schedule of taxes, I think your inquiring minds will find this a happy browsing ground.

Starting at the top, there is a comparison of the present net federal taxes and present provincial taxes computed at 28 per cent of the basic federal tax.

Senator Connolly Ottawa West): This is on page 2 of Study No. 3, is it?

The Chairman: Yes.

Mr. Gilmour: Yes, Senator Connolly.

The Chairman: It is really the third page of Special Study No. 3.

Senator Connolly (Ottawa West): Thank you.

Mr. Gilmour: This shows the personal income tax rates, not the corporate rates.

If I might give a very simple explanation, senators, of what I mean by net federal taxes and provincial taxes computed on the basic federal tax, our present system of taxation is that Canada imposes certain rates of tax. They are what I would call gross rates of tax, and, to use a simple illustration, if the federal tax computed under our present schedules amounted to the equivalent of 100, then that 100 would be reduced by 28 per cent, which is the credit for provincial taxes. So that under our present system you would pay to Ottawa 100 minus the 28, or 72. Then you would pay to the province in which you happen to reside whatever tax rate is imposed. We who have the fortune to live in la province de Quebec get a credit from our federal tax of 50 per cent, so we pay to Ottawa the equivalent of 50 and we pay to Quebec 50, so that we are even in that respect.

The Chairman: It still adds up to 100!

Mr. Gilmour: It really adds up to 106, Mr. Chairman.

Senator Molson: There is no discount for cash.

Mr. Gilmour: But our present federal credit, gentlemen, is based on the gross figure of federal tax. In other words, the gross rates of federal tax are reduced by 28 per cent for most of Canada, and then the provinces look to this basic tax to compute their own taxes.

To give you some indication of what the rates of the provinces are, on page 2 of this Study No. 3 I have listed in the second paragraph the provincial taxes. Unfortunately, gentlemen, when I was checking this last evening I found that the figures I typed here are, in part, obsolete as of January 1, 1970, so I have prepared a very small insert. We will now pass these out to you, gentlemen, and I apologize for this last-minute change.

While it is being distributed perhaps I could state that Newfoundland at the moment extracts a tax of the equivalent of 30.5 per cent of the basic federal tax. Newfoundland taxpayers get a credit of 28 per cent, so they are out of pocket to Newfoundland 2.5 per cent. Prince Edward Island and Nova Scotia just take the 28 per cent.

I must apologize to Senator Burchill, in pointing out that New Brunswick extracts 35.5 per cent, and since January 1, 1970 it is now taking 38 per cent.

Senator Burchill: That is bad news, Mr. Gilmour.

Mr. Gilmour: Yes. But equally to cheer you up, Manitoba is taking 39 per cent, so you really do not have the crown.

Senator Hollett: On what is the difference between the provinces based? Why does one province get 38 per cent, and another province...

The Chairman: That is the province's own tax rate.

Senator Connolly (Ottawa West): Perhaps it would help Senator Hollett if I put it this way. Mr. Gilmour say the dominion levies a tax of, let us say, $100. The provinces are entitled to levy a tax, and the dominion will give them each a credit of 28 per cent of the $100, or $28. But, a province, in addition to the $28, can levy taxes on its own which will increase the $28. That is why we find these differences.

Senator Hollett: I see the point now. If a province takes more than 28 per cent does the tax office in Ottawa still assume the obligation of collecting the provincial tax in excess of 28 per cent?

Mr. Gilmour: Yes, for each of the eight agreeing provinces the federal authority computes the tax on a uniform basis across the country, and it collects for the provinces whatever rate they want. In the case of New Brunswick...

Senator Hollett: And it takes the blame therefor?

Mr. Gilmour: No, I am not sure that it takes the blame. It collects the money.

Senator Hollett: I think it does take the blame. That is why I ask this question.

The Chairman: The federal authority is assigned the blame because it collects the tax.

Mr. Gilmour: Yes.

This is the present system that we use and, of course, in recent years the needs of the provinces for funds and revenues have led them to depart from the basic 28 per cent credit. As I have said, Manitoba is now taking a much higher percentage than 28 per cent.

We in Quebec have a basic credit of 50 per cent. In spite of many rumblings that Quebec is double-taxing those who live within its boundaries, in fact Quebec has extracted from its people a tax which is almost equivalent to the credit that is given them. I merely wanted to say that because sometimes there is a belief that Quebec is extracting a great deal more. To those of you who have any choice taxwise I say that it is cheaper to live in Quebec than in Manitoba.

Senator Benidickson: How new is the present Manitoba rate?

The Chairman: It dates from January 1, 1970.

Senator Molson: Except for Quebec the federal exemption for the other province is 28 per cent. In other words, in Manitoba there is an additional tax of 11 per cent?

Mr. Gilmour: Yes.

Senator Molson: But in Quebec the exemption is 50 per cent, so as the moment it is 50-50?

Mr. Gilmour: Yes.

The Chairman: The overall 100 per cent is the fund out of which the taxes are provided federally and provincially, but in Manitoba it is 100 per cent plus 11 per cent.

Senator Molson: Yes.

Senator Everett: I think it is important to point out that the 11 per cent is on the 100 per cent, and in points of tax it may be closer to 5 points. Is not that so?

Mr. Gilmour: Yes, the point I am seeking to make, senator, is that under our present system the federal tax is computed first, and it is the gross tax. I used the illustration of a tax equivalent to 100. That is reduced immediately by 28 to provinces other than Quebec. Because Quebec is running certain of its own programs the federal tax to Quebec taxpayer is reduced by 50 per cent.

As an example, for Ontario it is reduced by 28 per cent, but the Ontario Government so far has seen fit to impose a provincial tax of only 28 per cent of the gross federal tax. Manitoba, for good and sufficient reasons, has increased its provincial tax to 39 per cent of the gross federal tax.

Senator Everett: I am not sure that the reasons are good and sufficient, but the point I want to make is that the figure of 11 per cent does not indicate the actual effective tax rate. The effective increase in the tax rate is probably closer to five points of tax.

Mr. Gilmour: In 1969 Manitoba's tax was 33 per cent of the gross federal tax, and it has now been increased, as have the tax rate of a few other provinces.

Senator Beaubien: In Quebec we deduct 50 per cent, but then we pay provincial tax rates which are higher.

Mr. Gilmour: No.

Senator Beaubien: The Quebec provincial tax is higher than the 50 per cent federal abatement, is it not?

Mr. Gilmour: I believe not, senator.

Senator Beaubien: I thought it was a little higher.

Mr. Gilmour: No, it is exactly a half. I speak with some knowledge of this because my firm has offices in every province, so I have the privilege of filing tax returns in every province, but my home is in Montreal.

The Chairman: You speak from experience.

Mr. Gilmour: Yes, grim experience.

Senator Hays: So, Ontario lives with the 28 per cent?

The Chairman: Yes.

Mr. Gilmour: Ontario is an agreeing province so far as individual income taxes are concerned, senator. In respect to corporation taxes Ontario runs its own collecting system. At the moment, Ontario, in its wisdom, has seen fit to merely take the 28 per cent credit that the folk who live in Ontario get on their federal tax. In other words, taxwise today Ontario is one of the better provinces in which to live—that is, if you are looking solely at taxes.

Senator Hays: That is the personal income tax, but what about taxes on estates, and what about corporation taxes? Do you have anywhere in four study a note as to the increase in corporation taxes? These are personal taxes that you are talking about, are they not?

Mr. Gilmour: Yes, they are personal taxes. There is nothing in this particular study, senator, on the corporation tax. Generally, in Ontario the tax is 12 per cent of the taxable income of a corporation. In other provinces it

is 10 per cent, and I guess that 10 per cent is the more prevalent rate. In the Province of Alberta the rate is 10½ per cent, in New foundland, Ontario and Quebec it is 12 per cent, in Manitoba and Saskatchewan it is 11 per cent, and in the others it is generally 10 per cent. In 1970 the Newfoundland corporation tax has moved up to 13 per cent, which makes it the highest.

Senator Cook: I had a feeling that was right.

Mr. Gilmour: Yes, I regret having to read this obituary notice. In New Brunswick it is still 10 per cent.

Senator Connolly (Ottawa West): Mr. Chairman, Senator Hays has now interjected the element of corporation tax. Have we in this material a page comparable to this page numbered 2 which deals with corporation tax?

The Chairman: No, we have not developed that yet.

Senator Connolly (Ottawa West): So the only discussion of corporation tax that we will have before us is what is going into the record now?

The Chairman: At a later time, but not this morning, we can deal with the effect of them, but corporate rates as such are not being changed federally. They seem to agree in the White Paper that 50 per cent is enough.

Senator Croll: Mr. Gilmour, taking Quebec as 50 per cent, as you have indicated, and taking Ontario as 28 per cent, I assume that the difference between the 28 per cent and the 50 per cent which is 22 per cent comes to them through various programs in which they share, is that correct?

Mr. Gilmour: That is correct, sir.

Senator Croll: Then am I to assume that Manitoba does not share in the same programs in the same way as Ontario does and therefore they have 39 per cent.

Mr. Gilmour: I believe, Senator Croll, that Manitoba shares in exactly the same programs as Ontario, but due to financial stringencies in the Province of Manitoba the government there has seen fit to collect an additional sum of 11 points more than Ontario collects.

Senator Croll: But is there any greater stringency there than there is in Prince Edward Island, for example?

Senator Everett: The Manitoba government when it came into power reduced Medicare from $11 per month to $1.50 per month which sum they recovered by increasing the personal tax rate from 33 per cent to 39 per cent and the corporate rate from 11 per cent to 13 per cent effective January 1, 1970.

Mr. Gilmour: To answer your question, Senator Croll, I do not know enough about it, but I assume that Prince Edward Island would have equal financial stringencies; if you are a resident of Prince Edward Island, you would pay to the federal Government the equivalent of this 100 minus 28 so that you would be paying to the federal Government $72 and you would be paying to the province of Prince Edward Island $28. Now, if you were a resident of Manitoba you would still pay $72 to Ottawa but you would be paying $39 to the Province of Manitoba and the difference between the $28 you would pay to Prince Edward Island and the sum you pay to the Manitoba government would be based on the decision of the provincial government. You see Quebec, fortunately, is different and by agreement has withdrawn from certain of the family allowance and schooling allowance provisions and some others too. Consequently residents of Quebec receive an additional 22 points on top of the basic 28 points, so that we in Quebec pay $50 instead of $72 to the federal Government, but of course we pay $50 also to the Province of Quebec. So we are still in pocket by comparison with Manitoba, but we don't do badly in our own way.

Senator Benidickson: What was the new rate that somebody mentioned as being effective in Manitoba?

The Chairman: The new rate for Manitoba is 39 per cent.

Senator Benidickson: Which is 11 per cent more than the standard 28 per cent. Is that the highest provincial rate in the country?

Senator Connolly (Ottawa West): Yes.

Mr. Gilmour: Yes, Senator Benidickson, it is the highest, unfortunately.

Senator Connolly (Ottawa West): It might help to say this, Mr. Chairman, that I think that the formula of $72 for the federal treasury and $28 for the provincial treasury was worked out as the result of the forecast needs of the provinces for revenue. Then I think the policy that was set forth by the federal Government was simply this; if a province needs

more money, and Manitoba is an example, then let them levy their own income tax, and they have seen fit in this case to levy an additional $11.

Senator Hays: To round out the need for more money which Senator Connolly (Ottawa West) has referred to, do you think in our studies we should have also the same amount of sales tax from each province? For example, Manitoba has 7 per cent and I do not know about the others. I think it would be interesting to note the effect of the sales tax in computing the amount of money available.

The Chairman: Well, it does not bear on the subject of the White Paper but it does of course bear on a man's pocket-book.

Senator Hays: But it would be interesting to compare the figures.

Senator Phillips (Rigaud): Might I interject here, Mr. Chairman, to point out that that which is being discussed is not only interesting *per se* but it is also related to the fact that the new proposals require the consent of the provinces and therefore this has a bearing on what we are discussing now. It has a direct bearing on the White Paper and is not merely a comparison.

Senator Carter: Are the actual agreements with the provinces available to this committee? My understanding is that so far as the 50 per cent in Quebec is concerned, the extra 22 per cent was to compensate Quebec for certain shared-cost programs from which they chose to opt out. I would like to know if this 22 per cent or the 22 points granted to the provinces can be spent on programs at the discretion of the provinces?

The Chairman: Well, Senator Carter, there is such a thing as provincial autonomy. If they have their own money, I should imagine they could spend it in whatever way they saw fit.

Senator Carter: But is there any agreement between the federal Government and the provincial governments in this matter?

Senator Connolly (Ottawa West): I think the answer is no.

The Chairman: Can we now perhaps get back to Mr. Gilmour?

Senator Benidickson: May I for a moment refer to the last question raised by Senator Connolly when he pointed out that the increase shown in the standard 22 per cent is available in the Province of Manitoba. I think Mr. Gilmour said that the extra 11 per cent is still paid to a federal income tax agency, is that correct?

The Chairman: Collected.

Senator Benidickson: Collected and paid to a federal office of the Income Tax Department.

The Chairman: That is right.

Senator Molson: At the top of the first page of Special Study No. 3 there is an allusion to the basic federal tax. The term basic federal tax is the $100 we are talking about.

Mr. Gilmour: Senator, that is a very vital distinction, as I will try to show from the tables to the left on page 3 of Special Study No. 3. The first column shows the brackets of taxable income, which continue below. They start from zero dollars of taxable income up to $500, then from $500 to the peculiar figure of $909. That comes about because $909 is the point at which the present 20 per cent credit equals $20. We have this vestige of a tax reduction that we were given some years ago. It has been gradually chiselled down to the level of 20 per cent or $20. Why we still have it I do not know.

Then we move from $909 to $1,000. We go up and then there is $1,643. Again we have the point at which the $200 and 3 per cent temporary surtax apply, so we have a broken figure. These carry on page after page, but we are working here from taxable income, which means if we were talking of a married taxpayer, either an office worker or an artisan, he would ordinarily be entitled to an exemption of $2,100. Then, of course, additional exemptions, depending on the number of dependent children or other dependants he would have. To take a married man without children or other dependants, he has a basic $2,100 exemption at present. Then, of course, your taxable income starts above $2,100. In other words, at the bottom of page 3 where there is a bracket of $1,500 up to $1,643, that means that the man would have $3,600 of income, and taxable income of $1,500.

Moving to the right, the next column shows the present net federal taxes. This is the equivalent of the 72 that I was referring to earlier. The existing tax schedules that we have only show the $100 and then you have to reduce it by the 28, but in these tables we have made the reduction so that we can have

a meaningful figure before you. On the figure of $1,500 taxable income under our present rates, we would pay a net tax of $200 to Ottawa. Then we would compute the provincial credit on the gross figure, which is quite a bit higher than $200. At the present time that would be $50, being the credit for the taxes collected by the province. If you were in Ontario you would pay $50; in Manitoba you would pay somewhat more.

I wish to emphasize, if you will forgive me, that our provincial tax credits and our provincial taxes themselves are based on a gross figure of a federal tax. Our federal tax on this $1,500 figure would be something nearer $250 gross. This, less 28 per cent which would be roughly $50, would produce the provincial rate of 28 per cent.

Senator Cook: The taxpayer would make out a cheque for $250.

Mr. Gilmour: That is it. Now, if you will look at the right four columns on page 3 you will see the proposed net federal taxes. In the proposed taxes in the White Paper they have shifted away from the old formula. Today the White Paper publishes only a net federal tax. Again using $1,500 as the example, the new federal taxes, based on taxable income, would be $270.

The Chairman: As opposed to $200.

Mr. Gilmour: As opposed to $200. Then as you move from $1,500 up to $1,643 there would be 20 per cent of that $143, or whatever part of that you have. Then we have the suggested or proposed provincial taxes. These are no longer federal tax credits, because our new rates are net and our old rates were gross less 28 per cent credit. Therefore the proposal is that the province would collect 28 per cent of a net figure, not 28 per cent of a gross figure. Consequently we are in the position that in the past our provinces all based their tax, be it 28 per cent or 39 per cent, upon a gross figure. Today it is proposed that they collect whatever their tax may be upon the net federal tax, which is perhaps the equivalent of 72. One does not have to be much of a mathematician to know that 28 per cent of a hundred or 28 per cent of 72, or whatever the rate may be, is a vastly different figure. That explains the genuine concern of the provincial governments as to the accuracy and adequacy of our proposed rates and, particularly, the statistics on which our rates are based.

The Chairman: Mr. Gilmour, it would appear from the figure under the existing rates that the province would get $50 on its 28 per cent dealing with the $1,500.

Mr. Gilmour: Yes.

The Chairman: In the same column on the right side of the page dealing with the proposed rates, there is a figure of $76.

Mr. Gilmour: Yes.

The Chairman: Does that mean the province will get $26 more as a result of this proposal?

Mr. Gilmour: No, Mr. Chairman, because these two comparative taxes are both based on taxable income, and for purposes of our proposed taxes at this $1,500 level, if this were a married man it would not be $1,500 taxable income, it would be that minus $950. We would therefore have here taxable income of $550, so we drop down to the second line where, let us say the taxable income is $500 for simplicity, the proposed federal tax would be $85, and of course the proposed provincial tax would be $24.

The Chairman: I was taking the bottom line, but if I take the second line I have a column in the present rates of 28 per cent provincial rate, tax payable at the beginning of the bracket, for the province, $15, but going to the same column on the right, which is the proposed rate, I get a figure of $24.

Mr. Gilmour: That is right, Mr. Chairman, but there is a difference in the taxable income caused by this $800 and $150 proposed exemption, so we are talking of different computations of taxable income. Actually the right hand columns are all predicated upon a taxable income of minus $950.

Senator Cook: I think that is only meaningful within the small rates, is it not? When you get up to $13,000 and $15,000 the extra $400 or $800 is only a bagatelle.

Senator Molson: Am I not right in suggesting that the tax in the bottom line we are discussing of $270 federally and $76 provincially would now apply to a married man earning $4,550 instead of to the man we were discussing in the left-hand column who earned $3,600?

Mr. Gilmour: Yes, senator, that is correct.

Senator Molson: In other words, we have moved away from the man we were discuss-

ing on the left-hand side, who has a take-home pay of $3,600, and moved over to his friend who is doing a little better and is taking home $4,550, who pays this tax?

Mr. Gilmour: That is correct.

The Chairman: In order to get up to the amount of the tax we calculated, of course, the rates are increased.

Senator Cook: That exemption does not mean very much when you get up to $8,000 or $10,000.

Mr. Gilmour: It works out that this $950 or $550 benefit disappears with an unmarried taxpayer who has $2,310 of present taxable income; that is a single man, who gets $1,100 automatically, then $950, totalling $2,050, and another $2,310 on top of that. That is in the office boy class under our present salary ranges. The benefit of the $950 additional tax deduction is swept away by the new rates of tax. Moving to the married man, at a taxable income today of $7,041 the benefit is swept away.

I would refer honourable senators to the fourth and fifth pages of Study No. 3, which is marked page 2 in the top right-hand corner. There we get into the more meaningful brackets of tax.

Senator Kinley: May I ask a question?

The Chairman: Yes.

Senator Kinley: Do you take any account of municipal taxes?

Mr. Gilmour: No, sir.

Senator Kinley: They are all controlled by the provincial statutes.

The Chairman: This is the White Paper, the federal authority.

Senator Kinley: I know, but you are dealing with provincial taxes, and if you are dealing with taxation of the people of Canada you would take in municipal taxes in the White Paper.

The Chairman: No, we are not dealing with provincial taxes in the White Paper.

Senator Kinley: Then I do not know what we are dealing with.

The Chairman: We are dealing with federal taxes.

Senator Kinley: That is what I am saying, because municipal taxes are a factor.

The Chairman: They certainly are.

Mr. Gilmour: There is no reference to municipal taxes here, senator.

At the bottom of the page, in the bracket from $12,000 to $13,000, where we get into the executive level, our old federal tax was $2,486 at $12,000, and then it was 30 per cent on the bracket between $12,000 and $13,000. The provincial credit at 28 per cent was $804 plus 11.20 per cent of the excess. The new tax will be $3,000 plus 30 per cent of the excess, and the proposed federal tax will be $840. That comes about because the new federal tax is higher, and consequently while the $950 exemption sounds very attractive it rubs away at a taxable income of $7,041. From here on up people start getting soaked by these increased rates. As you let your eye travel over the increase in brackets on the following page...

The Chairman: Typewritten 3, but really the fifth page in the back.

Mr. Gilmour: You will notice here that it starts from $13,000 to $15,000 and then ends with $90,000 up to $120,000. In the executive group, which I suppose is the first half of the page of taxable income—$13,000 up—you will notice that the federal rates proposed are ever increasing so that our proposed rates are going to be substantially higher. You will notice, Mr. Chairman, in answer to an earlier question, that the provincial tax is reduced. I am looking at random at the figure of $25,000 of taxable income. Our present provincial 28 per cent would be $2,400. On the same bracket of income it would be $2,120. This comes about by the peculiar jumps in the brackets of taxable income and in the proposed rates. There is not much rhyme or reason. Of course, I do not think that there ever was any rhyme or reason in picking the graduated tax rates in the past, so I cannot really criticize the present draftsman repeating the same fault.

Senator Phillips (Rigaud): Other than the violation of the principle of the provincial receipts being reduced in the middle brackets or middle higher brackets—the net result.

Mr. Gilmour: It is these middle brackets that are going to bear the real burden of the increased taxes.

Senator Croll: The breaking point is $25,000.

The Chairman: No, it is more than that.

Senator Croll: It is just about that. What is the breaking point?

The Chairman: Let us look at the top of the page, senator. It is $13,000.

Senator Croll: From that point on what portion of the taxes paid by the people are below the $13,000 and what above?

Mr. Gilmour: I cannot answer that, senator, without access to more statistics than appear to be available. I will see if Mr. Nutt can tell us. These are 1967 taxation rates.

The Chairman: We will see if we can get that information for you.

Senator Croll: All right.

Mr. Gilmour: I would like to refer to that question later on.

Senator Burchill: A man with an income of $13,000 to $15,000...

The Chairman: Taxable income.

Senator Burchill: Under the present system he pays $2,786 and under the proposed rate he is going to pay $3,300.

Mr. Gilmour: Right.

Senator Burchill: An increase of $600.

The Chairman: Even with his increased exemptions.

Senator Burchill: That is what it amounts to.

Senator Cook: Why don't the rates go down?

Mr. Gilmour: As I say, there appears to be little rhyme or reason in these new rates. There was not much in the old rates either, but I have no explanation. You will notice in the lower brackets, up to $13,000 or taxable income—I have to refer you one page back on this to the centre of the page—that there is a bracket $6,000 to $7,000 and you will notice that under our present system you would pay, on a taxable income of $6,000, a provincial tax of $294, whereas under our proposed system you would pay a provincial tax of $364. At the bottom of the page, between $12,000 and $13,000, under our present system you would pay a provincial tax of $804 and under the new system $840, but then you hit this strange breaking point. I have no explanation for it. At $13,000 the scale tilts. The province starts to get less and that continues downhill.

At the bottom you will note the $90,000 figure. I know there are not too many individual taxpayers in Canada with that income.

Senator Phillips (Rigaud): Particularly senators.

The Chairman: Certainly not senators.

Mr. Gilmour: I am not competent to answer that question, senator. You will notice that the provincial tax, under our present system, would be roughly $12,620. Under the proposed tax it would be $10,464. This possibly explains some of the concern of the provinces. I would assume a province such as Ontario, which probably contains the greatest concentration of senior executives of corporate organizations, that under this proposed system, Ontario, if it bases its tax on these proposed rates is going to lose heavily upon the very class of people who are being soaked by the federal tax. Whereas, if we turn to one of the poorer provinces—I am reluctant to say who that is—with a lower level of income and the increased exemptions, admittedly there will be less federal tax paid. Of course, there will also be less provincial tax collected unless the provinces go a different route. The net result is that the individual taxpayer is going to be soaked.

Senator Leonard: Mr. Chairman, I would like to clear up one matter, which may be a misunderstanding. Mr. Gilmour, is it not the case that the figures on the right-hand side compared with the figures on the left-hand side do not take into account at all the increased exemptions, since you are not comparing the same man on each side of the page? You are only comparing the same figures of a taxable bracket. Is that not correct?

Mr. Gilmour: That is correct, senator Leonard.

Senator Leonard: When we say that the $90,000 man pays the provincial tax of $10,464 compared with $12,620, actually there is a still further decrease if you apply that exemption to that same man?

Mr. Gilmour: That is correct, senator. If I might add, the $950 additional exemption that is given could be swept away by an annual increase. The benefit that a taxpayer gets is taken from being at the present taxable income of $7,041.

Senator Leonard: I have down $7,241.

Mr. Gilmour: I am sorry, it is $7,041.

The Chairman: Is it clear to everybody that we are dealing only with amounts of taxable income on both sides of each page? We are not dealing with the amount of exemptions. We are just saying that on certain taxable income, that rate gives this result; and the new rates on the righthand side of the page gives this result.

Senator Connolly (Ottawa West): I am not being critical, but to be realistic, for the righthand side of the page if we are going to get the actual figures, then the deductions would have to be computed and applied. These figures are not going to be in effect realized. It is going to be the amount of these figures less whatever effect the deductions have on them.

Mr. Gilmour: Yes, senator, I have sought to get a common basis of the comparison of the rates, because as we know in practice the figure of taxable income is a very volatile thing. Today, I read that the guards in a Quebec penitentiary are demanding a basic salary of $10,000. There will be few skilled working men and junior office manager staff who are getting income in these very low brackets. Consequently, one statutory increase or one strike will most certain increase the taxable income possibly to offset these increases in the statutory exemptions. Of course, that is matter of opinion and I am not seeking here to say that these rates are wrong. I am merely trying impartially to indicate that this is a complete change in concept and is causing considerable concern to the provinces, because it is a change in basis. I notice in the morning paper that our Prime Minister has stated he would have a rerun upon these estimates of increased tax if the estimates proved to be incorrect.

These are the things that face us. They certainly are going to extract vastly increased taxes from what I might call the middle classes—and in that middle class, I would certainly include the skilled working man because of the effect of inflation upon our taxable income figures.

Senator Cook: Would the proposed treatment of dividend credits also cause a losing of money? Does this table here have anything to show that dividend—which is earned income and which is interest and so on?

The Chairman: These tables deal only with a comparison of existing rates on taxable income and proposed rates on taxable income. You have the greater amount of exemption in the proposed rates before you can get the area of taxable income.

Mr. Gilmour: Also, you are going to treat dividend credits...

Senator Cook: Will that cost the provinces money or not?

Senator Beaubien: In other words, what Senator Cook is saying is, if you can get a mix and get $20,000 devedend it makes a very big difference to the amount you pay. Has that been looked into? Has there been any kind of mix of dividends plus salary, plus interest, in calculating the tax on the amount?

Mr. Gilmour: In this study No. 3 at which we have been looking, there is no effect given for the increased dividend credits. At our first meeting, when we met with Mr. Bryce, we did have a paper before us then, which was a summary of Tables 15 and 16. Looking at the paper that we used with Mr. Bryce, I notice that the estimate of the increase in dividend credits will cost $140 million. This would be the cost to the country of giving an increased dividend credit to individuals. That $140 million in the first year rises to $230 million in subsequent years. That would apply in theory to every taxpayer in Canada.

From a practical point of view if you have an individual whose income is at the borderline of poverty, he is likely to have no dividend income. But there is this figure estimated by the Department of Finance.

Senator Cook: My question really was as to that $140 million. That is not going to be borne by the federal taxpayer? Will not that reduce the take of the federal treasurers, too?

Mr. Gilmour: That will reduce the take to the provinces.

Senator Leonard: Comparatively speaking, in the same way as this table shows. In other words, if a new method of crediting the corporate tax is in effect, this table will still show the result of that as between the federal share and the provincial share, in the same way as it shows with respect to earned income?

Mr. Gilmour: Yes, Senator Leonard, that is correct.

The Chairman: So you are looking to a larger amount of lessening of provincial revenue than just what is shown in this Table 3 by whatever the amount is of the dividend credit.

Senator Leonard: Yes, presumably from $7,041 up.

Senator Cook: It is no solution to the fellow getting $15,000 a year in salary to pay more tax, to be told that the fellow getting dividend is getting more credit.

Mr. Gilmour: If he has any dividend income.

Senator Cook: But if he has not, he only gets salary. It is no answer to him to tell him that the fellow getting dividends is getting more credits.

The Chairman: You have to have a dividend in order to get dividend credit.

Senator Beaubien: If we take this figure at the bottom of Page 3, $90,000, is he able to get some dividends in that? Because tax on dividends is quite different from tax on income in this figure of $90,000? Is it deemed that there are some dividends in there, or will that be all?

Mr. Gilmour: It is taxable income, senator, and that could include dividends. There has been no adjustment made to the tax.

Senator Cook: No credit is allowed?

Mr. Gilmour: No, not in these tables.

Senator Aird: Mr. Chairman, would it distort the concept that you are explaining, if the comparatives were in fact true? In other words, if your left-hand column represented a man in a certain situation and the right-hand column a man in the equivalent situation? I understand you are using figures only and that is your criterion. Would it distort what you are endeavouring to establish to this committee, if in fact you used a man in an identical position on both sides?

The Chairman: Well, the difficulty, Senator Aird, would appear to be that you have to get likes, and taxable income seems to be a common basis to determine how the rate structure treats taxable income and varying amounts at this time as against what the White Paper proposes. The other would really be dealing with individual cases.

Senator Aird: Yes, but it seems to me that we have to come to a comparative example, and, if we are going to illustrate this point accurately, other criteria do enter in, and it is an actuarial problem to find an average or mean citizen.

The Chairman: Do I understand you, Senator Aird? Are you suggesting that if I were to take a man with a taxable income of $25,000 and assume that 20 per cent of that was dividend income I could then make a calculation on both sides?

Senator Aird: Yes.

The Chairman: The existing rates and proposed rates and the credits?

Senator Connolly (Ottawa West): And the proposed exemptions.

The Chairman: And the credits on both sides.

Senator Aird: I think this is the point Senator Leonard is after. I really want to make sure that the comparison is meaningful.

Senator Leonard: I am satisfied that it is meaningful. The answer to Senator Aird's question is, if you do throw in the exemptions or do throw in the different tax credits, the picture is not distorted except to the extent that both sides go down a certain amount. But they will go down comparatively at the same rate as in this picture. So what Mr. Gilmour is saying, and what is true under any of these systems, is that the provincial share of a tax at $90,000, or anything above on this table, is going down compared with the present rate of tax.

The Chairman: And dividend credit would only reduce it more.

Senator Leonard: On both sides of the paper.

Mr. Gilmour: Senator Aird, may I say that I hesitated to submit involved schedules or to complicate them too much. In our working papers, prepared to test the accuracy of the tables, Mr. Nutt had prepared some typical cases with true comparisons. Just picking at random, we took a single man who ordinarily is entitled to an exemption of $1,100. We took a taxable figure, let us say, of $10,000 of taxable income, which would mean that that single man had a salary of $11,100. Under these proposed rates that single man will pay $284 more to the federal Government than at present, and he will pay an additional $21 of provincial tax to the province. That is assuming he gets his increased exemption under the two rates.

Just hitting at random, if we had a man with $24,000 of taxable income...

The Chairman: A single man.

Mr. Gilmour: A single man again. To make a meaningful schedule you would have to deal with the unmarried men, unmarried men with umpteen dependants, married men and then married men with umpteen dependants, and then wives with no income and so on. All this can be done quite easily, although it might be confusing. But taking at random an unmarried man making $24,000 of taxable income, that could mean today that his salary would be $25,100. Under the proposed system, giving him credit for the extra $550, he would pay an increased federal tax of $548, and he would pay a decreased provincial tax of $321. So if a province like Ontario has a lot of executives making $25,000, the provincial treasurer of Ontario has cause for concern.

Senator Aird: My point, sir, is, does it have a great number of single executives making $25,000? This is what is concerning me.

Mr. Gilmour: The same pattern follows, senator, for a married man making the $25,000, except that his deduction is a little larger.

Senator Aird: So what you are saying is that there is a distortion in fact, but that it is not so significant as to destroy the comparative that you are endeavorouring to establish. Is that correct?

Mr. Gilmour: I believe that to be correct.

Senator Lang: I assume that the philosophy behind increasing the exemption is that when the exemptions were last fixed the dollar was somewhat less firm than it is today, and you are really talking about the same kind of money, but represented by a larger figure—or the same buying power with a lesser dollar figure. Is there any way to relate that increased exemption to, say, the inflationary effects that have come into play since those exemptions were originally established at that level?

Mr. Gilmour: I believe not, senator. These rates are based upon the statistics for 1967. You see, it takes the taxation division a while to do this. The most recent publication is headed "Taxation Statistics 1969 Edition", but it says that it is analysing the returns of individuals for the 1967 taxation year.

Now, we could look at the varying rates that are in here, and it would be possible to extract any information we want out of them. If I might express a personal view, it may at first seem a little unusual to remove 750,000 people from the tax roll. Considering their standard of income and the cost of living today, it is my personal view that it is a jolly good idea. But to remove them costs the country $35 million. That is the figure Mr. Brown stated. From a strictly personal point of view, I ask why offer increased exemptions to all the rest of us who really don't need them—speaking for myself, anyhow—and then whacking up our rates so that you and I end up paying five or six times the benefit of the so-called increased exemption? I have wondered why we need disturb the whole system to carry out the desirable objective of removing a large group of people with border-line incomes from the tax role in our land. That is only my personal thought.

Senator Cook: Will there by any complex administrative changes arising out of this?

Mr. Gilmour: I believe not, senator. You see the assessment of individual taxes is highly mechanized today and removing these few souls from the tax roll will not affect the mechanism.

Senator Beaubien: Two strikes and they are back on.

Senator Carter: If I might ask a question to satisfy my own curiosity, has any study been done on what the medium taxable income is at the present time and what it will be under the new system?

The Chairman: You mean you are trying to strike an average income?

Senator Carter: No, the medium.

The Chairman: Where do you want to start? Where the taxable income starts?

Senator Carter: It could be somewhere between $4,000 and $5,000. I was wondering how this new system was going to effect the medium.

Mr. Gilmour: It is very difficult to get a typical taxpayer or an average taxpayer in Canada because our tax base really could be represented by a pyramid with a tremendously long base and extremely shallow apex. You see, our tax rates go up to $400,000 now and the number of individuals in Canada who have an income of $400,000 is very small. I doubt if it amounts to ten.

Senator Aird: It would make a very interesting bracket presentation if we could have this pyramid.

Mr. Gilmour: Out of a total of 6,655,000 taxpayers those who had an income over $200,000 is 140. Those who had an income between $100,000 and $200,000 were almost exactly 1,000. Now the largest single group of taxpayers are those who have an income between $5,000 and $5,500. In that bracket you have 451,000 taxpayers.

Senator Carter: That would be about half the total.

Mr. Gilmour: No, in the range of $5,000 to $5,500 there were 451,000 taxpayers out of a total of 6,655,000.

Senator Carter: How far up the scale would you need to go to get the first 3 million taxpayers?

The Chairman: I notice that in the White Paper they say that in the middle range two and one-half million people out of 6,650,000 taxpayers earned between $5,000 and $10,000 that year. That would be the sort of information you are seeking.

Senator Carter: It could be between 5 and 6,000.

Senator Aird: I think it would be of great assistance to this committee if this pyramid could be worked out and attached as an appendix to these proceedings.

The Chairman: Do you understand what Senator Aird wants, Mr. Gilmour?

Senator Aird: Shall I explain it to you?

Mr. Gilmour: Please.

Senator Aird: I would like to see in graphic form and using your words the pyramid with a very small apex at the top showing the disposition of taxable income in Canada.

Mr. Gilmour: I believe, Senator Aird, that I can prepare it. It will, however, have to be in the form of a chart, and if this is acceptable, we will draw the pictures.

Senator Molson: Mr. Gilmour, in the White Paper it is pointed out that after the new system has been in effect for a few years the rates then come down to a maximum of 50 per cent. In our proposals here I notice on page 5 that we go from 48 to 52, and then we go up to 64, but that will change with the passage of those four years.

Mr. Gilmour: Yes, senator. In my introduction to this study I qualified it by saying that where taxable income exceeds $24,000,—and here I am referring to the White Paper—the excess of federal taxes over 40 per cent and of combined taxes over 52 per cent will be reduced by 25 per cent. I just notice now, gentlemen, that on page 2 of this report in the paragraph marked (a) where I have put in 5.20 per cent, the decimal point is in the wrong place, and it should be 52 per cent.

The Chairman: Senator Molson, in your reference to the White Paper, you did not quote the number of the paragraph. Do you have it?

Senator Molson: No, I thought it was a paragraph in the White Paper but I was not sure.

Mr. Gilmour: I have prepared back-up schedules, Senator Molson, to give effect to what I would like to call these theoretical reductions in future income tax. They become very complicated and I will very gladly have them prepared if they won't be confusing. But my study itself merely looked at the proposed taxes as they will exist in the first year of the new system if it is adopted.

Senator Molson: I think you called our attention to a note on page 2 of this special study that contains matters we certainly should consider.

Senator Phillips (Rigaud): Mr. Chairman, would it not be desirable to add on to the special study 3 a further study to cover Senator Aird's point by taking a few hundred taxpayers who have a constant dividend income tax of say $5,000 and as you get into the higher brackets see what the results will be by comparing the present dividend tax credit against the proposed new system so as to be certain as we project this thing out that the results will not be significant in the terms of variations or conclusions we have before us. Instead of having another study, let it form part of Study No. 3.

If that were agreeable, Mr. Chairman, I would like, through you, to have us consider whether after the preparation of the completed Study No. 3 the same night be sent to the department for the attention of Mr. Bryce and Mr. Brown so that in due course, when we see them again, we might have the benefit of their views as to whether these conclusions are right.

I think we are dealing with a crucial and significant question here in dealing with the subject matter of the provinces, and I have already touched on the point that the success

or failure of this White Paper relates itself to the co-operation of the provinces; and if we are right in the conclusion that the provinces suffer by the proposed new system this, in my opinion, would be a matter of great significance.

Senator Molson: But it will appear on our record, will it not?

Senator Phillips (Rigaud): It could go on the record, but I am considering whether, prior to receiving Mr. Bryce and Mr. Brown again, we might consider the desirability of transmitting this study officially to them from this committee, pending our further invitation for the expression of their views.

The Chairman: Yes, we could submit the material and say that the next time they appear we will invite them to comment on it.

Senator Phillips (Rigaud): Otherwise we will waste time and they will say, "We desire a further delay in order to study it."

Senator Cook: Regarding the provinces and what they mighe lose, are we overlooking the fact they might gain something under the capital gains tax? Will the provinces get any share of the capital gains tax?

Mr. Gilmour: I do not think that we are overlooking it. I have prepared these studies strictly from the White Paper. The White Paper, as we found in our first meeting, estimates really very little increase of taxes from a capital gains tax.

The Chairman: Certainly a very low figure in the first year.

Mr. Gilmour: In the position paper we prepared at our first meeting with Mr. Bryce—which is headed up, "Proposals for Tax Reform—Effect on Tax Revenues"—this was really a summary of Tables 15 and 16 of the White Paper. In case you have not it here, I can read it to you.

Senator Cook: Which special study is that?

Senator Connolly (Ottawa West): Study No. 1.

The Chairman: No, this was filed the last time Mr. Bryce and Mr. Brown were here.

Mr. Gilmour: Yes, last Wednesday. It shows that where individuals are concerned the estimate of increased taxes resulting from tax and capital gains would be $60 million in the first year, rising five years hence to $245 million.

Then they have estimated the taxes on the unrealized capital gains resulting from the five-year revaluation to be in five years the equivalent of $100 million. I think that latter tax on the five-year revaluation appears to be in some jeopardy, but when you read the basis of computation of this capital gains to individuals, I think the basis of computation would well merit careful study.

Senator Cook: Is it the intention that the provinces would get 28 per cent of that tax?

Mr. Gilmour: Yes.

Senator Cook: So that would in some way compensate for what you fear would be the loss?

Mr. Gilmour: Yes, to the extent that these estimates of capital gains are accurate.

Senator Cook: Yes, I agree. You are dwelling all the time on what they are going to lose, and are perhaps forgetting there is the offset, though maybe not a complete one, as far as the authors of the White Paper are concerned.

Mr. Gilmour: The peculiar thing about the monetary effect of the White Paper is that there are three significant items that stick out like icebergs. Those three items are: the $1 billion reduction in tax because of the increased exemptions; the $1,255 million increase in taxes because of these new tax schedules that we have been reviewing; and the third item is an increase in corporation tax resulting from the denial of the lower rate of tax on the first $35,000 of taxable income, which is estimated to be $100 million in Year One and $390 million in Year Five.

Those are the three major items, and I should not use the word, but many other changes are "petty", and can only be so described.

Senator Aird: Would you be good enough to repeat the third point?

Mr. Gilmour: Gladly, senator. It is the increased taxes that will be collected from all corporations by denying them the present lower rate of tax, 21 per cent, upon the first $35,000 of taxable income. The estimated increase in tax from that denial—and this is being phased out over the period of years for the small companies—is $95 million in the first year of the new system and $390 in the fifth year.

What that means is, at present every corporation, be it big or be it very small, pays 21

per cent of tax upon the first $35,000 of its taxable income; and then it pays roughly 52 per cent upon taxable income in excess of $35,000.

This denial of the deduction means that a tax of $10,250 annually will be payable by every corporation. This is an increased tax.

As was brought out at some of our earlier meetings, this is going to have a most appalling effect upon the credit and the borrowing powers of the small corporation that is the backbone of our land. Admittedly, for the small corporation it is being phased out over a period of five years. For the larger corporation it is being taken away almost immediately.

Senator Aird: The input factor in coming to your conclusion in respect of those increasing figures is a fixed one, I gather? It bears no relationship to increased volume of sales, or whatever it is, or to gross revenue? It bears no relationship to the inflationary process or the increase in productivity? You are saying that this is a fixed figure which is measurable without relationship to the economy or outside factors?

Mr. Gilmour: Yes, senator. I would merely add one thing, that I am quoting from the White Paper. I may be drawing conclusions, but all estimates are directly contained in the White Paper. I think one of the major criticisms that we can direct at these figures in the White Paper is that they pay no attention to what may happen, and to what probably will happen, in the way of growth, to our GNP, to our population, and perhaps to our national wealth. These estimates are based solely on the past, so that the estimate of the corporation tax, I think, is doubtful. There will be a much higher amount collected in the future because of the normal growth of companies.

Senator Cook: On this point of the two-two-rate system of taxation, recently I read the following:

> .. at the present time American Corporations are taxed at the rate of 22 per cent on the first $25,000 of profit, and 48 per cent on profits in excess of $25,000, and the proposals for changing the United States Tax Act do not embrace the cancellation of the two-tier structure as do the Canadian Tax Reforms.

Do you know if those are the correct rates?

Mr. Gilmour: I believe those are the correct current rates, senator. You have to realize that in the United States there is a substantial State tax that varies with the different States, and probably the maximum effective rate in the United States is around 54 or 55 per cent.

Senator Cook: But there is a two-rate system that is in effect?

Mr. Gilmour: That is right.

Senator Phillips (Rigaud): On that same point, Mr. Chairman, may I just point out, so as to get our thinking integrated, that it was because of this very question of the GNP in future years that I asked Mr. Bryce whether in the Department of Finance they had a projection of the GNP for the next five years and which is not reflected in the White Paper. His answer, in effect, was: No.

Senator Lang: I am wondering if there are statistics available as to the number of corporate taxpayers in Canada who pay tax on not more than $35,000.

Mr. Gilmour: We do not have them in any of the published statistics. I am certain that the Department of Finance must have such figures.

The Chairman: I can tell you the figure I have been looking for, Senator Lang, for the purpose of the proposition I put to Mr. Bryce the last time. If you recall, the proposition was that you could draw the line of taxable income at $100,000, and any company not having more than that should be entitled to 21 per cent on the first $35,000, and then would pay the full rate on the rest. A company having earnings in excess of $100,000 would pay the full rate. This would give relief. I pointed out that if this was phased out over a period of ten years then the saving in tax would be over $10,000, so your small taxpayer would have a nice cushion that would establish good credit facilities for him.

Senator Cook: Not if he was incorporated in the ninth year.

Senator Aird: May I come back to the second iceberg?

The Chairman: This was the top of the iceberg.

Senator Aird: No, the second iceberg is that to which Senator Phillips has referred. I am sorry, but I was out of the country last week, and I am not familiar with Mr. Bryce's reply.

The Chairman: His reply was that this would be giving a subsidy, whereupon I asked him: If you have one rate for an individual income of $15,000 a year, and another rate for an income of $20,000 a year, was not that a subsidy in one sense? He agreed with that. The answer was that it was a subsidy.

Senator Aird: Are we in a position as a committee where we are about to receive a reply from Mr. Bryce on this point?

The Chairman: The information I intend to get is as to what amount in dollars would be affected if your establish the proposition I have suggested. I do not think it would be a substantial amount. In other words, you are only giving the 21 per cent to companies earning not more than $100,000, and you are only giving it to them for $35,000 of that amount, and when you offset the application of the full corporate rate to all other companies there will be a substantial gain in income.

Senator Laird: Mr. Chairman, are we not entitled to information as to the exact number of companies that are below $35,000?

The Chairman: If it is available, then we will get it.

Senator Laird: That is what I mean. If it is available, should we not have it?

The Chairman: Yes.

Senator Everett: Apropos Senator Molson's point, I wonder if we could have a table which would show the rates exigible on incomes in excess of $24,000 after the fifth year. The table here shows the first year, and I think it would be interesting to see a table showing the fifth year.

Mr. Gilmour: Yes.

Senator Everett: My second point is apropos provincial revenue. It seems to me that in suggesting that provincial revenues are reduced you are isolating your argument on the subject of personal taxes. I refer you to table 13 at page 94 of the White Paper which indicates that in the first year—it does not go beyond the first year—the provincial revenues are increased by 20.4 per cent. I think it would be interesting to ask Mr. Bryce and Mr. Brown what the projections are for the second, third, fourth and fifth years.

The Chairman: To which table are you referring?

Senator Everett: Table 13 at the top of page 94. That shows total revenues, presumably, from all income taxes.

The Chairman: The difference that is suggested there is only $20 million.

Senator Everett: They are suggesting in the first year that provincial revenues will be up by $20 million as a result of the adoption of the proposals in the White Paper over the present system in the same year.

The Chairman: Yes. You will have to calculate how they have equalized the input, and what they gain and what they lose. We have seen, so far as individual incomes are concerned, that they are losing.

Senator Everett: That is right, but they are suggesting that in the overall they are gaining.

The Chairman: We should have an analysis of that.

Senator Everett: Yes, and we should also ask what happens in the second, third, fourth, and fifth years.

The Chairman: Yes. Senator Molson, I think the paragraph you may have had in mind is paragraph 2.42, which states:

> The Government has concluded that as the taxation of capital gains becomes fully effective, and transitional measures in the new system have ceased to be important, top rates of combined federal and provincial personal income tax should be reduced to 50 per cent.

I notice the significance of the words "should be reduced". It does not say will or may, but I suppose it means that if you are acting intelligently it would be reduced.

Senator Molson: But again they cannot speak for the provincial Governments, who have been discussing the fact that where they need a little money there is only one way to get it.

The Chairman:

> The top rates...

And that is individual and corporation, to get down to 50 per cent.

> ...should gradually be reduced from the present levels, in four instalments commencing in the second year in which the new system applies.

You have given consideration to that, Mr. Gilmour, in the tables which you have prepared.

Mr. Gilmour: I shall give it. I would point out, Senator Molson, that when I became a tax collector in 1937. I think on January 2, an individual had to have about $6,000 of income before he paid $100 income tax. Corporations paid roughly 7.5 per cent of their taxable income. I think they have increased somewhat since then and I hope I will be permitted to wonder how realistic the prospects are of the individual rate going back to 50 per cent.

Senator Beaubien: Mr. Gilmour, you pointed out that taking 750,000 people off the tax roll would cost the state $35 million.

The Chairman: This was Mr. Brown's figure at the last meeting. I wonder if Mr. Gilmour has a figure as to what would be the loss in tax revenue by establishing the highest individual rate at 50 per cent?

Senator Beaubien: Could Mr. Gilmour give us a tax scale which would take 750,000 people off the tax roll and only cost $35 million, which could be added to the rest of the scale so that it would come out even?

The Chairman: That would not be difficult.

Senator Beaubien: By giving everyone the exemption it cost $1,255 million.

The Chairman: We have been shown that in a substantial number of cases it is given then taxed back.

Senator Molson: Seven dollars a head.

The Chairman: Yes. You may as well have a poll tax, or something similar.

Mr. Gilmour: Senator Beaubien, in the position paper we used for our first meeting, which is just a summary of tables 15 and 16, it said the reduction in the top rate of tax on individuals to 50 per cent will decrease the revenues five years hence by $40 million.

The Chairman: The decreases in rates, which I take it would also bring into consideration the increase in exemptions, would be $35 million, plus $40 million, in other words $75 million, and we go into this complexity by extending the exemptions over the whole scale.

Senator Beaubien: Should we not write a new rate and show them just how it should be done?

The Chairman: It is a little early. Remember, we are judge and jury here; do not start making judgments too soon. We have been slugging away at this and absorbing a lot of very useful information. I do not want to wear you out. Is there some other particular matter that should be considered today? How do you feel about calling it a day at this time, Mr. Gilmour?

Mr. Gilmour: With your permission I am perfectly prepared to continue, unless I wear my welcome out.

The Chairman: You are not likely to do that.

Mr. Gilmour: We have already covered page 3 of our agenda, which is the low rate of income tax. My only comment concerns the third paragraph on page 3 of the agenda. We do not know how many corporate taxpayers there are, but when the Minister of Finance appeared before the committee, I think I should say in the other place, Mr. Chairman..

The Chairman: No, you can call them the Commons committee.

Mr. Gilmour: When he appeared before the Commons committee he made a couple of comments that I have listed in the paragraph numbered 3. Mr. Benson said:

> (a) there are about 180,000 incorporated small businesses, of which about 90,000 pay taxes, and
>
> (b) there are 20,000 corporations with assets over $100,000.

Those are completely meaningless figures, really.

Senator Molson: How did the assets suddenly pop into this fruitcake?

The Chairman: I do not know. They do not contribute anything to the consideration of the problem.

Senator Molson: It is a brand new approach, is it not?

Mr. Gilmour: Yes, it is really a meaningless statement. There is one controversial point, Mr. Chairman...

The Chairman: Yes. I should tell the committee and maybe the subject matter will be of such interest to you that you would concentrate for a little while longer. I raised the question with Mr. Gilmour of dividends received from foreign corporations, because it

is going to have a bearing on the presentations that are made to us by a lot of companies. Noranda was here, and there are other companies in the same field with the problem of the effect of the proposals in relation to dividends received from foreign corporations. Mr. Gilmour has prepared a memorandum, which is on page 4 of the topics for discussion. I do not think it would take very long to deal with it, would it Mr. Gilmour?

Mr. Gilmour: It should not, unless there is discussion. Then it might be continued at your pleasure.

The Chairman: Would you like Mr. Gilmour to outline it, then we can decide whether we have done enough today?

Mr. Gilmour: Gentlemen, the present treatment under the Canadian law of a foreign subsidiary is that if a Canadian company—we can refer to Noranda because it did make representations on this point—owns more than 25 per cent of the voting stock of that foreign subsidiary, then such a company as Noranda can bring the dividends of that foreign subsidiary into Canada and pay no corporate Canadian income tax on the dividends received. Instead, the dividend falls into the accumulated earnings of Noranda and in due course will be distributed by way of dividend to the shareholders of Noranda, where it will be subject to tax or, if it goes to non-residents, it will be subjected to a withholding tax, probably of 10 per cent. That is contained in section 28(1) of our present Income Tax Act. It dates back to roughly 1948. Prior to that time there was a most involved computation in the old Income War Tax Act so that when a dividend was brought from a foreign subsidiary into Canada a credit was given or the income tax that had been paid to the foreign land. That credit was given if and when the dividend was brought in. There was no compulsion to bring the dividends from the foreign lands into Canada.

My recollection is that at the time Dr. Clark and Dr. Eaton were in the Finance Department they felt this formula was much too complicated, and they simply threw it away in favour of the simple rule of thumb of 25 per cent ownership. This rule presupposed that if business was done through a foreign subsidiary in a foreign land the taxes required by that foreign land would be paid. Sometimes those taxes were higher than in Canada, sometimes lower. Last week we heard from the President of Noranda that countries like Mexico, and other South American countries generally, extracted taxes of around 35 per cent or less. More civilized countries like Ireland offer tax holidays, and very generous tax holidays.

Senator Phillips (Rigaud): Have you any information on the State of Israel?

Mr. Gilmour: Yes, senator. I have communicated with them, and I regret that their tax rates are rather vicious. No doubt they will work them down in due course.

The proposal in the White Paper is to sweep away all this exemption. In paragraph 6.21, particularly, there seems to be a suggestion that it is rather an immoral act to have a subsidiary in a foreign land, that the only reason it is done is to dodge Canadian taxation. That seems to be the basic theory set out in paragraph 6.21.

Our present system is a happy-go-lucky one, if you like. It recognizes that Canadian industry must operate abroad and that a tax will be paid to the country in which the business is carried on. If that country imposes a tax less than Canada's, under our present system Canada does not care; Canada knows it will get the dividend income and some day will collect tax on the dividends. Admittedly where a business is carried on abroad there is sometimes a choice in arranging the country where the business will be carried on. Obviously anybody in the mining business cannot go to tax-haven countries like the Bahamas, Bermuda, Lichtenstein or all the old traditional places; they have to go where the mineral deposit is. Similarly, anyone buying or manufacturing articles abroad goes to a country where it is most economic to do that.

On the other hand, quite a number of companies have been formed in, say, the Bermudas or the Bahamas, on the principle that there is no law in Canada saying that anyone wishing to do business beyond Canada must conduct that business in the most expensive way taxwise. Rather, as free citizens they have the choice. Amongst clients of my own firm of which I have personal knowledge there are, as an example, engineering companies that render services throughout the world. They have rendered services in Canada and paid their Canadian taxes. They also render services in countries like India, and others, and pay their taxes to the Indian or Pakistani government, as the case may be. It is then their custom to accumulate the earnings, or what is left of the earnings, in a holding company in Bermuda. They do not do the business in the name of the Canadian company. In some cases business cannot be

done in the name of a Canadian company. In Mexico they would deal through a Mexican company, and similarly in many other parts of the world. The fact is that by creating a foreign company earnings can be assembled beyond the Canadian company, and then the accumulated earnings can be brought as a Canadian tax exempt dividend into Canada.

Whether these things can be likened to an abuse, I personally doubt. I think our present tax laws are such that no Canadian company could take income that is earned from carrying on a business in Canada—to use the American expression, take Canadian source income earned here—and successfully transfer that to a tax-haven country. I think it is impossible. In fact, I know it is impossible because I have spent many an hour trying to figure out how I could do it, and it cannot be done.

Senator Phillips (Rigaud): The statute says so. It says you cannot delegate income belonging to you to another source.

Mr. Gilmour: Equally, our present statute says that a foreign business does not have to he carried on in the name of a Canadian company. In the United States, during the early days of the Kennedy administration—when I am told their Treasury Department was staffed by professorial staff of Harvard University—the Americans introduced a section, probably rampant with American imperialism, that looked right through the international borders. In their internal revenue service they introduced what is called sub-part F. In United States tax jargon everybody currently talks about sub-part F income. I will not seek to define it now; it would be too lengthy. Basically, if a United States corporation has a foreign subsidiary in what are called developed lands, the United States tax collector reaches out beyond the international border and says, "We will tax this revenue at United States tax rates. We will give you certain credits for the foreign tax that you may pay. If you are in a less developed country—" and there is a list of them—"we will not tax you."

The Chairman: Unless you bring it home.

Mr. Gilmour: Until you bring it home. This sub-part F has actually been a most unpopular piece of legislation since 1962 when it was introduced. It is on that point that Senator Phillips (Rigaud) this morning has asked for a study, but I am told that in the United States, as recently as yesterday, it is doubtful that sub-part F has collected much over $1 million in revenues since 1962. I have not been able to check that figure, although it came from an individual who is knowledgeable in United States tax matters. I am also told that there have been so many ways of dealing with this sub-part F that it is on its way out in the United States tax legislation. However, we in Canada are quite prepared to take up other people's garbage and our White Paper in effect proposes that we adopt the United States system. This proposal containing sort of innuendo, that it is improper for a Canadian company to do business through a foreign subsidiary or if you do you must pay the same tax that you would pay if you were doing the business in Canada.

If this proposal is adopted it is going to have a major effect upon many Canadian companies. Gentlemen, I am letting my personal views come out because I believe this. We have many Canadian companies that have foreign subsidiaries and many of these companies in foreign lands pay a much lesser rate of tax than they would in Canada. The proposal briefly is this: If you have a subsidiary in a foreign country with whom we have a tax convention—we have 15 tax conventions, mostly with countries such as the United States, the United Kingdom and then countries on the western seaboard of Europe and many Commonwealth countries like Australia and the like. We also have one with the Republic of Ireland. As long as you are doing this in a treaty country then you can bring the dividends of that treaty country back home to Canada free. I mention Ireland because I have been having a lot of dealings with their Treasury Department. When the White Paper first came out I incidentally told them that it was possible that the tax exemption they were giving might be swept away by our sub-part F. That was considered to be an immoral suggestion and I am glad to say that it was wrong, because we have a treaty with them. In the Dominican Republic we have no treaty and if we had a profitable company there Canada would reach out and tax it. I would assume that the Dominican Republic, wanting to build up business, probably gives a tax holiday and pretty low rates to attract industry. We feel that to be improper so we tax the income here.

I can incidence another case that may come up. Many of our eastern oil companies buy their crude oil from Venezuela. They determine the price by treaties and other things. The rate they pay for this crude oil is often

much less than the posted price, but they must bring that crude oil into Canada at a posted price, otherwise they might be subject to certain special custom duties. The result is that every international oil company in the world has an offshore subsidiary that purchases the crude oil at whatever the international agreement may be, bringing it into Canada at the posted price to equate Venezuelan oil possibly with the western oil prices. These offshore companies pay no Canadian tax. Under our proposal, if these companies were to continue operations in various countries in the world, their income would be deemed to be brought into Canada and taxed at the Canadian rates. The answer to this is going to be—I believe that some companies have expressed themselves publicly on this—that the Canadian parent company might very easily create a new company, possibly under the laws of the Bermudas. It would exchange its shares which would be listed for the shares of the top Canadian company and then arrange that any of the foreign subsidiaries would become direct subsidiaries of the new Bermuda corporation and the Canadian operating company would also be a subsidiary of Bermuda. The result of that would be that these foreign companies would not pay Canadian tax. Their dividends would not be brought to Canada, but would go directly to the new foreign creation. Not every Canadian company can or will do that. However, there are some of these companies to which these proposals mean the difference between corporate life or death. When the devil drives I guess they might consider going to Bermuda and other places.

I have intermingled, honourable senators, what should have been an impartial statement on this proposal with my own views of the results of the proposal and I apologize for doing that. This proposal is one on which your committee will be receiving many rather vehement protests. It is not directed at the Canadian who tries improperly to move Canadian revenues out of Canada. That fellow has been caught long ago. This is directed at the Canadian businessman seeking to expand his business and who goes wherever in the world he can go.

The Chairman: Yes, but Mr. Gilmour, in many countries in the world the foreigner cannot own. For instance, the mineral properties in Mexico, it must be a Mexican company and Mexican nationals must hold 51 per cent. If it is in what they call the crown reserve property, I think it is 33 or 34 per cent. So the kind of complications that may be created would look to be pretty substantial, if you are going to carry out operations in other countries—where you must, because of their national viewpoint, operate in the way their law says you are to operate.

Senator Beaubien: With Venezuela, have we got a tax agreement?

Mr. Gilmour: No.

Senator Beaubien: Is not that the answer, that we have to have a tax agreement?

The Chairman: It takes two people to make an agreement.

Senator Phillips: I think that two crucial points that Mr. Gilmour has are that we should all be in favour of taxing income which emanates from Canada but not to destroy the activities of international operations that Canadians engage in.

The Chairman: And that are beneficial to Canada.

Senator Phillips (Rigaud): Yes, and in terms of ultimate movement of dividends, protection of the Canadian dollar, the flow of trade.

The Chairman: Senator Phillips, you should say, the provision of substantial revenues for our balance of payments.

Senator Phillips (Rigaud): Yes, I would just touch on that. That is why, at the initiation of today's discussion, amongst my three questions, I had that basic one, which Mr. Gilmour touched on—because he and I get the same information from the same sources—this offshore arrangement in the United States is falling flat on its face, and here we are attempting to introduce something that is a manifest failure in the country to the south.

The Chairman: Honourable senators, we have had a very interesting and informative morning, but also a heavy morning. I would thank Mr. Gilmour very much. We have much more in the mill in the way of studies on the White Paper to present to you but we do not want to overpower you on one morn-

ing. I suggest we adjourn now and meet on Wednesday of next week. You will be told the agenda in good time. We have had various briefs and indications of various times that people will be available to come, and we will get this information to you.

In the meantime, this course of instruction and education we are getting will be very valuable in assisting in digesting the material and in asking pertinent questions.

The committee adjourned.

APPENDIX "A"

SUMMARY OF "PROPOSALS FOR TAX REFORM"

November 7, 1969

INDEX TO PROPOSALS FOR TAX REFORM

NOVEMBER 7, 1969

1. STATUTORY EXEMPTIONS

A. *Personal Exemptions*

(1.25) To remove or reduce taxes on lower-income taxpayers the government proposes to increase the basic personal exemption for a single person to $1,400 from $1,000 and for a married couple to $2,800 from $2,000. The basic standard deduction available in lieu of deductions for charitable donations and medical expenses would remain at $100. Consequently those taxable as single persons with income under $1,500 would have no tax to pay and those taxable as married would have no tax to pay if their incomes were under $2,900. These new exemptions would be much higher than those in other countries as shown in Table 3 page 26.

(2.4) These factors led the government to propose an increase in personal exemptions to $1,400 from $1,000 for single taxpayers (or married taxpayers filing as single) and to $2,800 from $2,000 for married taxpayers filing as such. The deductions for children and other dependants would remain the same, although some of the conditions relating to them would be changed as noted below. These new exemptions plus the $100 standard deduction, which would be continued, would mean that those entitled to the married exemption would be exempt up to an income of $2,900 and single persons to $1,500. These increases would free from income tax about 750,000 persons now subject to tax.

(2.16) The law now permits a taxpayer to claim the exemption of a married person under certain circumstances even though not married or married but separated. It is proposed to continue this special use of the exemption only for those who support a child or other relative who lives with the taxpayer. Where they live elsewhere, only the deduction for supporting the dependant would be allowed, plus the new child care deduction, if it applies. The provision that permits both a married exemption and a deduction for dependants to be claimed where a fulltime servant is employed would be dropped as unnecessary in view of the new child care deduction. The married exemp ion would also be discontinued for an unmarried clergyman who employs a fulltime servant and maintains a self-contained domestic establishment.

(2.17) It is necessary to reduce the extra exemption for married status where the wife or husband of the taxpayer has an income and to reduce the deduction for children or other dependants where they have an income of their own. This should be done gradually by reference to the income of the dependant so there is no abrupt dividing line causing unfairness between those just over and just under it. For this purpose it is proposed that the additional exemption of $1,400 for a married man be reduced by $1 for every $1 that his wife's income exceeds $100, so that he would be taxed as a single person when her income is just enough to make her taxable. The same rule would apply where a wife supports her husband. In the case of children under 16, for whom the deduction is $300 (and for whom family allowances are normally payable) it is proposed that the parent's deduction be reduced by $1 for every $2 of income of the child in excess of $900, so that the deduction would disappear when the child is taxable on his own income. For older children and other dependants, for whom the deduction is $550, the taxpayer's deduction

would be reduced by $1 for every $1 that the dependant's income exceeds $950, so that this deduction too would disappear when the "dependant" becomes taxable. The amount of $950 is used in the present rule for dependants but the deduction is abruptly cut off when income exceeds this level. In determining the income of a student, for this purpose as well as for his own taxable income, tuition fees may be deducted.

(2.18) An additional amount of $500 is currently added to the personal exemption for a person over 70, or for a blind person, or for a person confined to a wheelchair. Although the royal commission recommended that this be cancelled, it is proposed to continue this additional exemption for such taxpayers on compassionate grounds. It can be argued that this is not the best way to assist the incapacitated or the elderly but most of the incapacitated benefiting from this provision have relatively small incomes, and taxpayers' needs tend to increase with age.

B. *Income of Husband and Wife*

(2.5) The royal commission proposed that the family, including dependent children at home, should be taxed as a unit, using a separate schedule of rates from that applicable to individuals. The government considered this proposal carefully, as there is logic in the argument that the family, or at least the husband and wife together, is the basic spending unit. A number of other countries either permit or require the incomes of husband and wife to be added together for tax purposes. However, the commission's proposed family unit tax would have imposed a "tax on marriage"—that is, a husband and wife each having an income would together pay more tax than two people with the same incomes who were not married. This we felt to be unfair and undesirable at least for small and medium incomes. Even then, however, a wife who goes to work would have her income added to her husband's income and in effect taxed at the rates that would apply if his income were increased by the amount of her income. We are not prepared to undertake at this time such a change to a new system with a separate rate schedule. After the basic reforms proposed in the present paper are in effect it would be possible to reconsider separately a family unit basis, or a more complicated system similar to some of those used in other countries, as a further instalment of reform.

C. *Deductions for Dependants*

(2.6) The government has reviewed the deductions allowed from taxable income for children and other dependants—currently $300 per year for children under 16 and $550 per year for others. We believe any action on these should be related to the further evolution of Canada's social security and social development programs. These programs are now under review. In the meantime, it is proposed that deductions under the Income Tax Act for children and other dependants remain as at present, and family allowance payments remain exempt.

2. INCOME

Sundry Amounts to be Included in Income

A. *Unemployment Insurance Benefits*

(1.36) The government has decided that it would make the tax system fairer if the treatment of unemployment insurance were changed to permit workers to deduct their contributions to the fund and to require them to pay tax on benefits received. Many of the benefits are received by employees with average or higher than average incomes who are unemployed for relatively short periods, and whose annual incomes equal or exceed the annual earnings of others. The higher their incomes the greater the tax benefit. It is fairer to tax them on this part of their income, as long as we permit all employees to deduct their contributions. Anyone on unemployment insurance benefits for most of the year is likely to pay little or no tax.

(2.22) The most important of these changes would make unemployment insurance benefits taxable and make employees' contributions to the Unemployment Insurance Fund deductible from income. Many employees receive unemployment insurance benefits for part of a year although they may have earned substantial other income during the rest of the year. Tax exemption for these payments is unfair to the person who earns the same total income but who must pay more tax. The higher the employee's regular income the greater the advantage of the present tax-exempt treatment of benefits.

B. *Social Assistance Benefits*

(2.23) Social assistance payments to those in need would not be taxed if made under feder-

al or provincial legislation or by a registered charitable organization subject to a needs test or means test. The test would be sufficient evidence of inability to pay, and the circumstances of those to whom the payments are made would normally make reporting of income and assessment of tax impractical. On the other hand, systematic payments under the Old Age Security Act should continue to be included in income, although in practice the new personal exemptions would free them from tax where they are a taxpayer's only income.

C. *Scholarships*

(1.37) It is also proposed, in fairness to other taxpayers, that fellowships, research grants, scholarships and bursaries be treated as taxable income but subject to the deduction for tuition fees and costs incurred for research. Undergraduates would seldom need to pay tax because few scholarships and bursaries are larger than the new personal exemptions plus the fees that may be deducted from students' incomes. But if students have other income, there is no reason why they should not be taxed like other Canadians.

(2.24) Until now most fellowships, scholarships, bursaries and research grants not related to services have been treated as exempt from tax. There seems no valid reason for continuing such exemption. Post-graduate students and research workers are, in effect, professional workers and should pay tax as others, after allowances for tuition fees and for research expenses properly deductible from research grants. Payments to undergraduates normally fall well within the personal exemptions, after deducting tuition fees. Where they exceed exemptions or where the student has other income, he should pay tax just as other Canadians do.

D. *Adult Training Allowances*

(2.25) With unemployment insurance benefits and student bursaries becoming part of income subject to tax, the same should be true of adult training allowances paid under the Adult Occupational Training Act. The allowance paid to trainees for living away from home would not be included in their income.

E. *Teachers from Other Lands*

(2.26) Under our tax treaties with Britain, the United States and a number of other countries, professors and teachers who have come to Canada temporarily are exempt from Canadian income tax on their teaching salaries for two years. In some circumstances they are not taxed by the country where they are normally resident. Given the present scale of salaries of professors and teachers this arrangement is unjustified. We intend to remove this exemption, on a reciprocal basis, from our treaties and to tax such persons like others.

F. *Armed Forces*

(1.38) For many years, members of the armed services have been taxed under special regulations which are aimed at simplicity of administration but confer special benefits. The regulations are no longer necessary on administrative grounds and would be dropped. Members of the Canadian armed forces would then be taxed under the normal terms of the Income Tax Act.

(2.27) A special section of the Income Tax Act permits members of the armed services to be taxed under regulations on a monthly basis. For simplicity of administration various short cuts and adjustments are made in determining their income and taxes. This leads to some special benefits for some members of the forces. Under present circumstances members of the forces can be taxed on the same basis as other Canadians and it is our intention to do so.

Capital Gains

A. *Proposal*

(1.28) The government has decided to include capital gains and a number of other benefits in income subject to tax. Reviews of this subject by the royal commission and the government led to the conclusion that this is essential in order to be fair between those receiving such gains and others deriving their incomes from other sources. Moreover, the taxation of gains is essential to block loopholes effectively. The economic effects of taxing gains have been appraised and are considered unlikely to interfere significantly with incentives to save and invest in Canada.

(1.30) In general we propose to include capital gains fully in income for most classes

of assets whenever they are realized by the sale of such assets, and to allow realized capital losses to be deducted from income. Certain exemptions would be permitted for taxpayers' homes and for articles of personal property. Special rules would apply to the marketable shares of widely-held Canadian companies. On such shares accrued gains would be taxed every five years and accrued losses allowed as deductions at such time. Only half the gain or loss on such shares would be taken into taxable income in recognition that the corporation income tax paid by such companies is only partially credited for personal income tax. This is explained in Chapter 3.

(1.31) Once capital gains are included in taxable income, the portion of the total income of the wealthy that is brought to tax would be dramatically increased. The tax system would be significantly more progressive even without the ostentatiously high rates now in use. It is proposed that the marginal rates in excess of 50 per cent be reduced to the neighborhood of 50 per cent in four instalments as the capital gains subject to tax increase. As the estimates in Chapter 8 indicate, based on 1969 incomes by the fifth year of the new system the inclusion of capital gains in taxable income should add about $345 million to personal income taxes, while the reduction of the top rates to 50 per cent on other income should cost about $40 million.

(3.13) The government proposes that capital gains be subjected to a progressive tax as part of the general income tax system. Depending on the nature of the asset, all or part of the gain would be included in income and taxed at the taxpayer's marginal rate. Similarly, all or part of capital losses suffered by a taxpayer would be deductible from taxable income and so save the taxpayer tax at his marginal rate. It would be necessary to prohibit the deduction of losses which are in fact the result of personal consumption: for example, the loss on a sale of the family car.

B. *Change in Tax Rates*

(3.14) If capital gains are included in income for tax purposes, the portion of the total income of the well-to-do that is brought to tax would be dramatically increased. As previously mentioned, the income tax system would become significantly more progressive, and we would no longer need the very high rates of tax in order to have a fair system.

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C. *Valuation Date*

(3.15) The government does not propose to tax gains that arise before the new system is introduced unless those gains would have been taxed under the present system. Consequently, the general rule would be that taxpayers could deduct from the proceeds of sale of assets the value of those assets on "valuation day". Consider the case of the taxpayer who bought a block of shares in 1964 for $1,500 which today is worth $2,500. If the new system were to go into effect with today as valuation day, and if the taxpayer were to sell his shares a year from now for $2,600, his taxable gain would be only $100. If he were to sell them for $2,100, he would have a loss for tax purposes of $400.

(3.16) The natural and ordinary thing to do would be to proclaim that valuation day is to be the day on which the new system is to begin. However, if that were done, the pressure on market prices on that day could be tremendous, and the opportunities for price-fixing too great. To avoid these consequences, the government proposes to choose a day close to the beginning of the system and to announce that evening that it was valuation day.

D. *Accrued Gains and Averaging of Income*

(3.17) Once the tax on capital gains had been part of the system for a few years, taxpayers would begin to report gains that had accrued over several years. In the absence of special provisions, this could result in a much larger than usual income in that year and could make the taxpayer liable for a marginal rate of tax considerably higher than the rates that would have applied had his income been spread over the years during which the gain accrued. The averaging provisions described in Chapter 2 would overcome this effect.

E. *Principal Residence of Taxpayer*

(3.19) Generally, capital gains on the sale of homes would not be taxed. This would be accomplished by providing that when a taxpayer sells his principal residence only the profit in excess of $1,000 per year of occupancy would be taxed, and by granting the "rollover" discussed in the next paragraph. Both of these provisions would of course apply on the sale of a farm with farmhouse that has been a principal residence. The $1,000 per year exemption would also compensate for

the fact that losses on the sale of a taxpayer's residence other than a farmhouse sold with the farm, would not be deductible from income for tax purposes. The government believes it would be virtually impossible to distinguish between losses which arise from changes in the real estate market and losses which arise from the aging of the house and normal wear and tear. Naturally in calculating his profit the taxpayer would be able to take into account the cost of the improvements he has made. If he does not bother to keep records, he would be allowed instead a home improvement allowance of $150 per year of occupancy.

(3.20) In addition to the exemption, the government proposes that a taxpayer who moves from one area to another within Canada in connection with a change of job should be entitled to treat the sale of his home and the purchase of a home in the new area as a non-taxable transaction. In technical terms, he would be granted a "rollover". If the taxpayer spends the proceeds of the sale of one house on the purchase of another within a year from the date of the sale, any profit that would be taxable on the sale of the old house (that is, after deducting the exemption) would be deducted from the cost to him of the new house. In this way, the profit would increase his gain on the ultimate sale of his new house (or reduce his loss), and tax would not be due before that time.

(3.21) A taxpayer who has two homes could only claim the exemption or the rollover with respect to one of them. He would have to declare which is his principal residence. Similarly, a husband and wife would have to choose one principal residence for both of them, unless they are separated pursuant to a divorce, judicial separation or written separation agreement.

F. *Gains on Assets, other than Principal Residence*

(3.22) This category would include such things as cars, boats, stamp collections, paintings, sculptures and cottages, etc. It might, therefore, include assets that the owner hopes can be resold later for more than they cost after he has had the use or enjoyment of them for a time.

(3.23) If all profits on this type of asset were to be taxable, Canadians would have to become a nation of bookkeepers. The government proposes a rule which should have the effect of significantly reducing this record-keeping. When a taxpayer sells such an asset, he would not be taxed unless the proceeds exceed $500. If the proceeds do exceed $500 he could deduct from those proceeds either his cost or $500 whichever is the greater. This would have the result that Canadians need keep a record of the purchase of items of this type of personal property only if the cost of the item exceeds $500. To protect the revenue it would be necessary to provide that a series of sales of items of a set would be treated as one sale in applying the $500 limit.

(3.24) As a companion to the $500 rule on gains, losses would not be deductible unless the item sold cost more than $500. If an asset did cost more than $500, the deductible loss would be computed by deducting from the cost either the proceeds or $500, whichever is greater.

(3.25) Because this category of assets involves items bought for personal use or enjoyment, it would also be necessary to impose some over-all limitations on the deductibility of losses. Otherwise, some taxpayers could reduce their taxable income by deducting personal expenses. Therefore, the government proposes that if an item in this category is of the nature that it depreciates through use, a loss on the sale of this item would not be deductible. Examples of this type of asset would include furniture, cars, boats and cottages held for personal use.

(3.26) A second type of asset within the general category does not decrease in value through use. In this group one would include paintings, sculptures, jewellery and coin and stamp collections. However, in order to recognize the personal nature of these assets and of the losses resulting on their sale, the government proposes that such losses be deducted only from gains realized on the sale of the same type of asset. If the taxpayer does not have enough taxable gains of this nature in the same year to absorb the deductible loss, the balance could be offset against such gains either in the immediately preceding year or in the year immediately following.

G. *Investments in Bonds, Mortgages and Rental real estate, other than Principal Residence*

(3.28) This category would involve investments such as bonds, mortgages, agreements for sale, and rental real estate. It is proposed

that profits from the sale of these assets be brought fully into taxable income and that losses on the sale of assets of this type be fully deductible in computing taxable income. Taxpayers who obtain bonds, mortgages and agreements for sale at a discount with a low coupon yield would be in the same position as taxpayers who buy at par with a higher coupon yield.

(3.29) The general rule that tax payers would not be taxed on more than the increase in value of such investments after valuation day would apply to these assets. Further, if bonds, mortgages and agreements for sale that a taxpayer now holds are worth less on valuation day than the taxpayer's cost—or his "amortized" cost if he bought it at a discount—the recovery of cost or amortized cost would not be treated as income. For example, if a taxpayer bought a 6 per-cent bond at $100, and that bond is quoted on the market on valuation day at $85, there would not be tax on the redemption or sale of the bond unless the taxpayer receives more than $100. Another taxpayer who purchased a bond of that issue in the market for $80 would be taxed on redemption or sale if he receives more than the $85, unless writing the $20 discount off over the remaining term of the bond would have increased his "amortized cost" to more than $85.

(3.30) The government does not wish to force Canadians to compute the "amortized cost" of their present portfolio of bonds where the original discounts were small. Therefore, if a taxpayer had purchased an issue for 95 per cent or more of its face value, he would be exempt from tax on sale or redemption, unless the proceeds exceed the face value of the bond. These transitional arrangements would, of course, only apply to taxpayers who are not at present taxable on the realization of discounts. Bond traders, chartered banks, life insurance companies and others who are now taxable on the realization of discounts would continue to be so.

H. *Revaluation of Assets every Five Years*

(3.33) Taxpayers other than widely-held Canadian corporations would include only one-half of their gains on the sale of these shares in taxable income and deduct only one-half of their losses. However, they would be required to revalue these shares to market value every five years and take one-half of the resulting gain or loss into account for tax purposes in that year. A special rate is proposed for widely-held Canadian corporations to avoid double tax. This is explained in Chapter 4.

(3.34) The rule that only one-half of gains or losses would be taken into account for tax purposes would put Canadians in approximately the same tax position regarding capital gains and losses on these shares as most of the non-residents who invest in Canada. Specifically, it would put them on approximately the same footing as American individuals and corporations and British individuals and corporations. It would be impracticable to attempt to tax non-residents on their profits on the sale of small blocks of publicly listed Canadian shares.)

(3.36) The proposal that the accrued gains or losses on those shares be taken into account every five years is one of two exceptions to the general rule that capital gains and losses would be taxable only when they are realized. (The other exception concerns taxpayers who leave Canada.) Periodic revaluation would reduce somewhat the value of the half-gains rule. It would reflect the fact that these shares are readily marketable and that a taxpayer can, therefore, realize his gain or loss fairly easily at the time of his choosing. The shares of private companies do not have the same marketability.

(3.37) Periodic revaluation would also reduce the "lock-in" effect that might well otherwise occur. If a taxpayer faces a tax on the sale of an investment, and that tax is postponed if he holds on to the investment, he may feel "locked in". As long as he holds, he would have, say, $100 working for him. If he sells, he would have only, say, $90 or $95 to reinvest. Since periodic revaluation would reduce this lock-in effect, it would reduce what might otherwise be an obstacle to the workings of the capital market. Revaluation would also make it feasible for the government to classify more corporate reorganizations and mergers as tax-free transactions than would otherwise be the case, thus removing a tax barrier that might otherwise have impeded transactions that are desirable for economic reasons. Finally, it would reduce the tax postponement which would otherwise result from the treatment suggested in paragraph 3.42 to those cases where the lack of marketability of the assets made the treatment compelling.

(3.38) The process would not begin until five years after capital gains become taxable. Beginning in the fifth year, individual taxpayers would revalue their holdings of shares of widely-held Canadian corporations in each year in which they attain an age that is divisible by five. Corporations would also revalue their holdings of these shares every five years, likely on the fifth anniversary of incorporation and each other anniversary divisible by five. Dispersing the valuation process through a five-year cycle would reduce the pressure in any particular year—the pressure of the work load on the administration and the pressure that might otherwise develop on market prices every five years. To further disperse this latter pressure, it is proposed that revaluation take place as of the end of the month in which the significant birthday or anniversary takes place.

I. *Deemed Realizations every Five Years*

(3.39) The general rule would be that capital gains and losses would be taken into account for tax purposes in the year in which the taxpayer disposes of the asset. Several exceptions are proposed to this rule. Some would result in tax not being due even though the taxpayer has sold the asset. These are explained later under the heading "rollovers". Two would result in a gain being taxed even though the taxpayer has not sold it. In the preceding section of this chapter a procedure was described whereby the gains accruing on shares of widely-held Canadian corporations would be taxed every five years, whether or not the owner sells the shares.

J. *Deemed Realization if Taxpayer changes Residence from Canada*

(3.40) The other deemed realization would occur when a taxpayer gives up Canadian residence. The general rule would be that he would be treated as if he had sold all his assets on that day at their fair market value. On the other hand, when a taxpayer moves to Canada he would generally be treated as though he had on that day purchased his assets at their fair market value. The combination of these two rules would mean that Canada would tax only the increase in value that arises during the time that the owner is resident in Canada.

K. *Gifts and Bequests*

(3.41) Special rules would be required to provide equitable treatment should a person give an asset to someone. The act now contains rules that apply when depreciable property is transferred by gift. Under these rules, the person making the gift is treated as if he had sold the asset for its fair market value and then made a gift of the proceeds. The person receiving the property is treated as if he had purchased the asset for its fair market value. These same rules would apply if other kinds of property are gifted during the lifetime of the donor.

(3.42) If the same rules applied when property was transferred on the death of the owner, it is possible that two taxes could apply at the same time—an income tax on the capital gains accrued on assets owned by the deceased, and an estate tax on the property which he leaves. Further, these taxes could apply at a most inconvenient time. To avoid this situation, the government proposes that capital gains not be accrued at the time of death but that the person who inherits the assets be treated as if he had purchased them at their cost to the deceased. This cost would be increased by part of the death taxes paid on the assets in question—the part that relates to the capital gain. In this way, there would not be a capital gains tax unless or until the executor or beneficiary disposes of the asset.

L. *Proceeds of Insurance*

(3.44) Examples of forced realizations are expropriations and the collection of insurance proceeds or damage claims in connection with the destruction of an asset. In either of these cases, if the taxpayer uses the whole of the proceeds to purchase similar property within a year of the receipt of the proceeds, a gain that would otherwise be taxable would be treated as a reduction in the cost to him of the new property. Therefore, the gain would only be taken into account for tax purposes if and when he disposes of the replacement property. If he should spend less than the full proceeds, any amount that he keeps would be considered to be part of the gain and would be taxable immediately. In that case, of course, that part of the gain would not reduce the cost to him of the replacement property. As explained earlier, this same process would apply where a taxpayer uses the proceeds of sale of one home to buy another home in connection with certain changes of employment.

M. *Transfer of Assets to Controlled Corporation*

(3.45) The second type of transaction which would qualify for a rollover would almost always involve a corporation. If a taxpayer transfers some of his assets to a corporation in which he owns all of the shares, there is a sale within the legal definition of that word, but there has been no change in the underlying beneficial ownership of the asset. The government proposes that this fact be recognized by treating the transaction as though it had been a sale at the cost to the taxpayer of the property transferred. Tax would be postponed until either the corporation sells the assets or the individual sells his shares in the corporation.

(3.46) For example, suppose that a taxpayer owns an apartment building in which his undepreciated capital cost is $300,000 but which has a market value of $500,000. If the taxpayer transfers this apartment building to a corporation in exchange for the common shares of the corporation, then, assuming he owns all of the shares of the corporation, there would be no taxable gain at the time of the transfer. Rather, the corporation would be treated as having purchased the building for $300,000, and the taxpayer would be treated as having purchased the common shares of the corporation for $300,000. If either subsequently sells its asset, tax would then become due.

(3.47) For technical reasons, this rollover must be restricted in three ways. First, it cannot be granted with respect to transfers to foreign corporations, otherwise the gains might slide right through the Canadian tax net untouched. Nor can it be granted with respect to transfers to widely-held Canadian corporations or with respect to transfers of shares of widely-held Canadian corporations. Since gains on the sale of those shares would be only 50 per-cent taxable and losses only 50 per-cent deductible, the provisions necessary to achieve the appropriate ultimate result would be too complex.

(3.48) This treatment of transfers would also apply at the time of incorporation of a partnership, provided the partners have exactly the same economic interest after the incorporation as they had before. Generally this would mean that they would have to receive the same proportion of every class of share or claim against the corporation as they previously were entitled to receive of partnership profits and assets.

N. *Winding-Up of Closely-Held Corporation*

(3.49) Somewhat similar rules would govern on the winding-up of a closely-held Canadian corporation. If there is only one shareholder, the tax treatment would be designed to put the parties in the same position as if, first, the corporation had sold its assets to that shareholder for a price equal to the cost to him of his shares in the corporation, and then the corporation had distributed those proceeds on winding-up. If there is more than one shareholder, the treatment would be similar provided all shareholders have exactly the same economic interest after liquidation as before.

O. *Distributions on Re-organization of Corporation*

(3.50) If a corporation splits its shares without increasing its paid-up capital, it would be a tax-free transaction and each shareholder would spread the cost to him of the old shares over the larger number of new shares. If, however, the corporation includes something else in the transaction—for example, in a reorganization involving common shares it includes debt claims or shares that are not common shares—it is proposed that shareholders be treated as having realized their potential capital gain to the extent of the value of this other asset that they have received. Also, if rights are varied in the reorganization—some shareholders receiving one thing and other shareholders of the same class receiving something else—it is proposed that it be a taxable transaction.

(3.51) Most other reorganizations or mergers involve a change in economic interest—a barter. It is proposed that, at least initially, these transactions be treated as taxable realizations if they involve closely-held Canadian corporations or foreign corporations. It may still be possible later to identify more situations in which a rollover can be granted without permitting taxpayers to accomplish tax-free in an indirect manner what would be taxable if done directly.

P. *Speculative Land Profits*

(3.53) Paragraph 3.15 sets out the general rule that taxpayers could deduct from the proceeds of sale of assets the value of those assets on valuation day. If this rule were

applied to all assets, some Canadians would be excused from tax under the new system who would have been taxable under the present system. For example, a land speculator who purchases a farm for less than its current value is taxable under the existing system if he sells that farm. It would be perverse if a change that was designed to increase the percentage of the income of the wealthy that is brought to tax should in this particular instance create an exemption for the speculator. The law would be drafted in such a way as to make sure this does not happen.

Q. *Recaptured Capital Cost Allowances*

(3.54) Another example concerns taxpayers who own depreciable property that they are using for income-earning purposes. Consider the case of a taxpayer who bought an apartment building for $500,000 and has over the years claimed depreciation for tax purposes of $200,000. Under the present system if he sells the apartment building for more than $300,000, the next $200,000 is treated as a "recapture" of the depreciation he has been permitted and either directly or indirectly comes into the computation of his taxable income. Only if he sells the building for more than $500,000 will any part of the proceeds be considered a capital gain—the excess over $500,000. The act would be drawn up in such a way as to make it clear that the taxpayer is still liable for tax on recaptured depreciation.

R. *Taxation of Sale of Shares of Closely-Held Corporations*

(3.31) The definition of a closely-held Canadian corporation is given in Chapter 4, but it would include most Canadian private corporations. Gains on the sale of shares of these corporations would be fully taxed, and losses on the sale of such shares would be fully deductible (subject to protection against the deduction of personal expenses). This treatment, when coupled with the credit given to Canadian shareholders for the Canadian corporate tax paid by these companies, (see Chapter 4) would produce a balanced system in which there is little if any tax advantage to be secured by a taxpayer through receiving his share of the income of the corporation in the form of gains on the sale of shares rather than dividends, or vice versa. This would remove one of the strongest temptations to tax avoidance in the present act. It would also produce a system in which the weight of tax on private companies is identical to that on the unincorporated businesses with which they compete. This balance is explained more fully in Chapter 4.

(4.33) Meanwhile gains realized on the sale of shares in closely-held corporations would be taxed as ordinary income, and losses suffered on the sale of such shares would be deductible from other income for tax purposes. When coupled with the system of full integration, this would mean that the tax effects would be the same whether an individual causes his corporation to sell its assets to a prospective purchaser or chooses to sell his shares to that purchaser, thereby giving the purchaser indirect control of the assets.

(4.74) The full deductibility of capital losses suffered on the disposal of shares of closely-held Canadian corporations gives rise to a need for special transitional arrangements affecting those corporations. This need may best be explained by giving an example.

(4.75) A corporation which purchased an apartment building 10 years ago might now have a balance sheet somewhat as follows:

Apartment building, at cost		$500,000
Less accumulated depreciation		200,000
		300,000
Land, at cost		50,000
Total assets		$350,000
Mortgage payable		$205,000
Shareholder's equity:		
Common shares	$75,000	
Accumulated earnings	70,000	145,000
		$350,000

(4.76) Under the existing system, the shareholders of the corporation would be liable for personal tax if the accumulated earnings of $70,000 were distributed. Further, if the apartment building could be sold for $500,000, there would be corporation tax due on the 200,000 of recaptured depreciation, and personal tax as well when the net proceeds were distributed to the shareholders.

(4.77) Assuming the shares of this corporation are worth $345,000 at the start of the system ($500,000 for the building plus $50,000

for the land, less $205,000 for the mortgage), both of these taxes would be forgiven. The corporation would still pay a tax on the recapture of the depreciation ($200,000 at 50 per cent=$100,000) and a dividend of the resulting accumulated earnings of $170,000 would still need to be reported by the shareholders as income of $270,000, including the taxable credit of $100,000. However, on winding up the corporation, the shareholders would have a deductible loss of $270,000—their opening valuation of $345,000 less $75,000 received on winding up. This loss would offset the dividend income and the shareholders would receive a refund of the $100,000 corporation tax paid by the corporation.

S. *Taxation of Sale of Shares of Widely-Held Corporations*

(3.22) The final category of assets for special mention consists of shares in widely-held Canadian companies. Again, this phrase is defined in Chapter 4, but it would include listed Canadian companies and Canadian companies whose shares are traded over the counter.

(4.42) As mentioned above and in Chapter 3, the government proposes that half of the gain on the disposal of a share of a Canadian public corporation be taken into account in computing taxable income. This lower rate of tax on the gain would complement the partial credit given for corporate tax and provide the other half of the government's incentive to Canadians to invest in Canadian corporations. To forestall a fairly straightforward tax-avoidance technique, it would be necessary to grant deduction for only half of the loss on the sale of such a share.

(4.45) Proceeds from the sale of a share of such a corporation after it becomes a widely-held corporation would be taken into income for tax purposes to the extent of 50 per cent, even though part of the increase in value may well have occurred while the corporation was a closely-held corporation. This provision reflects the expectation that closely-held corporations would distribute—either by cash dividend or stock dividend—almost all of their profits to their shareholders, and that the accruing capital gain, if any, on such shares would therefore relate almost entirely to the expectation that the corporation would be able to earn greater profits in future. Because the shareholders would receive credit for only half of the corporation tax paid on these future profits, it is reasonable that the government collect tax only at half rates on the sale of those future profits.

T. *Taxation of Capital Gains of Non-Residents*

(3.34) The rule that only one-half of gains or losses would be taken into account for tax purposes would put Canadians in approximately the same tax position regarding capital gains and losses on these shares as most of the non-residents who invest in Canada. Specifically, it would put them on approximately the same footing as American individuals and corporations and British individuals and corporations. (It would be impracticable to attempt to tax non-residents on their profits on the sale of small blocks of publicly listed Canadian shares.)

(6.43) The general proposal to include capital gains in taxable income would require changes to the international provisions, including the extension of Canadian tax to gains by non-residents on the disposal of real property, partnership interests and branch assets in Canada.

(6.44) Given the ease with which a gain on the sale of other assets can be transformed into a gain on the sale of shares of a corporation, it would also be necessary to tax certain gains by non-residents on the sale of Canadian shares. This need is strongly reinforced as regards closely-held Canadian corporations by the implications of the regime suggested for Canadian shareholders of those corporations. Since a Canadian can obtain full credit for the Canadian corporate tax paid by the corporation, and can deduct the full cost of his shares from his income when he sells those shares, he can afford to pay the full value of the corporation's assets (including creditable tax as an asset) when he buys the shares of the corporation.

(6.46) This is the appropriate result provided the vendor is taxable on his capital gain on the sale of the share. He and/or the owners before him would have paid tax on the full $60,000 on the sale of their shares. Canada would have collected one tax—and only one—on the $60,000. But the vendor must be taxable, or the $60,000 would escape

tax. Therefore it is proposed that non-residents as well as residents be taxed on their gains on the sale of shares of closely-held Canadian corporations. This would be buttressed by a "back-up" provision to place a responsibility on the purchaser to ensure compliance. A system of "certificates of compliance" would be necessary for private company share transfers—an awkward but necessary evil.

(6.47) The same implications do not apply in the case of widely-held Canadian corporations. Canadian shareholders would receive credit for only half of the corporate tax paid and would be entitled to deduct only half of their loss on the sale of their shares. Also, it would be impracticable to attempt to tax non-residents on their sales of small lots of these shares. Therefore it is proposed that only those non-residents who are selling shares out of a substantial interest (25 per cent or more) would be taxable in Canada.

U. *Profit and Loss realized by a Canadian Public Corporation from sale of shares in another Canadian Public Corporation*

(4.59) Special rules are needed to cover the case of a public corporation which receives a dividend from another public corporation. If the dividend were taxable at normal corporate rates, the effect would be to collect more corporate tax in those instances where there are intercorporate holdings than in those instances where the individual shareholder holds his share in the operating corporation in his own name. To overcome this shortcoming it is proposed that a special tax rate be applied to the dividends received by Canadian public corporations from other Canadian public corporations. The rate would be 33-$\frac{1}{3}$ per cent so that this type of intercorporate dividend would be tax-free provided the corporation paying the dividend had paid sufficient Canadian corporate tax to cover the dividend. This special rate would also be applied to capital gains realized by one Canadian public corporation on the sale of shares in another Canadian public corporation. Finally, the loss suffered by one Canadian public corporation on the sale of a share in another Canadian public corporation would reduce tax only at this special rate. The effect of this rate on dividends passing through an intercorporate chain is illustrated in the following schedule:

	Corporate Chain	Direct Ownership
Dividend paid by public corporation No. 1	$100	$100
Public corporation No. 2		
Dividend received	100	
Plus taxable credit	50	
Taxable amount	150	
Gross tax, at $33\frac{1}{3}\%$	50	
Less credit	50	
Net tax	0	
Amount available for distribution	100	
Creditable tax (gross tax amount)	$ 50	
Individual shareholder		
Dividend received	$100	$100
Taxable credit	$ 50	$ 50

V. *Mutual Funds*

(4.61) Open-end mutual funds and most closed-end mutual funds would be widely-held corporations under the definitions proposed earlier in this chapter. As a result shareholders would receive the dividends that flow through the mutual fund subject to the same tax as if they had received the dividends directly. There is one exception to this, in the case of dividends from a closely-held corporation that are routed through a mutual fund. In this instance the government feels it appropriate to levy the same taxes on this portion of the corporate income as if the earnings had been in a public corporation. The relationship of the shareholder of the mutual fund to his corporation is much the same as that of shareholders of other public corporations to their corporations.

(4.62) A special rule would, however, be required for mutual funds. This type of corporation must be able to put its shareholders in the same position as if they themselves had realized their proportion of the capital gains of the mutual fund arising on the sale of shares in public Canadian corporations. In the absence of a special provision mutual fund shareholders would pay tax on the full amount of such gains when they were distributed to them, whereas tax should be applied only to half of the gain. Consequently

this type of corporation would be enabled to make special distributions to its shareholders which would be treated as though they were a capital gain on the sale of a Canadian public corporation. The effect of this proposal is illustrated below:

	Mutual Fund	Individual Shareholder
Gain on sale of shares	$300	$300
Tax:		
At 33⅓% on the gain	100	
At say 40% on one-half of the gain		60
Net gain	200	
Special dividend distributed to shareholders	200	
Taxable credit	100	
Taxable amount	300	
Gross tax, at 40% on one-half	60	
Less credit	100	
Refund	40	
Net amount retained		
Dividend plus refund	$240	
Gain less tax		$240

Dividends Received by Canadians from Controlled Foreign Corporations

(1.47) There would be some changes in the taxation of income earned by Canadian residents and corporations from sources outside Canada to prevent "tax havens" being used to evade Canadian taxes. Individuals would continue to pay Canadian taxes on investment and other income from sources outside Canada. They would receive a credit for the withholding tax or other income tax paid directly to governments of other countries. Corporations would also receive such credits except when income is from a controlled foreign corporation.

(1.48) New distinctions between classes of foreign corporations controlled from Canada are outlined in Chapter 6 and will be further elaborated in supplementary papers. Unless tax treaties provide otherwise, Canadian corporations would be taxed on dividends received from foreign corporations in which they have a substantial interest. However, they would receive credit for the withholding taxes levied on the dividend by the foreign country and for the corporation tax paid by the foreign corporation on the profits from which the dividend was paid. Tax treaties would maintain the exemptions for dividends received from foreign corporations more than 25 per cent owned by the recipient Canadian corporation, and carrying on bona fide active business operations in the foreign country. Other provisions patterned generally on the United States law would impose full Canadian taxes on corporate income accruing in "tax-haven" operations. Various other detailed safeguards would be introduced to keep to a minimum the use of non-resident corporations to reduce Canadian taxes of Canadian residents.

(6.11) The system by which the government proposes to attain its objectives is set out in the following paragraphs. These paragraphs deal successively with dividends from controlled foreign corporations, passive income of controlled foreign corporations, other foreign investment income, business profits and salaries and wages earned abroad by Canadians, and a new procedure for giving shareholders of Canadian corporations credit for the foreign withholding taxes paid by their corporations.

(6.15) The government has concluded that neither of these systems is either "right" or "wrong". It proposes to continue in a restricted form the present exemption of dividends received by a Canadian corporation from a controlled foreign corporation. For this purpose, the Canadian corporation would be assumed to control the foreign corporation if it owns 25 per cent or more of the voting shares of the foreign corporation. The first restriction proposed is that the exemption privilege would be extended only to dividends from those countries with which we have concluded bilateral tax treaties. A second is that the effect of the exemption would be eliminated for certain types of diverted income by the proposals described below under the heading "Passive Income of Controlled Foreign Corporations." These restrictions are necessary to frustrate efforts to use the dividend exemption to reduce artificially the tax burden on tax-haven income.

(6.17) A dividend from a Canadian-controlled foreign corporation not protected by tax treaty would be subject to a tax-credit

regime. The Canadian corporation would be allowed a credit for the foreign withholding taxes imposed on the dividend and for any foreign corporate tax imposed on the underlying business profits from which the dividend was paid. This would reduce or eliminate taxes due on the dividend, which taxes would be computed on the dividend plus the tax for which credit was available.

(6.18) The existing dividend exemption system would be retained for several years, at least through 1973, as a transitional measure until an appropriate network of international tax treaties can be built up.

(6.19) Subject to the limitation noted below, the general capital gains provisions would apply to the shares of controlled foreign corporations—gains realized on the disposal of them would be fully taxable and losses fully deductible (except of course to the extent that the gain or loss accrue prior to valuation day). However, because full corporate tax would not be collected on dividends from such corporations it would be necessary to place a limit on the deductibility of losses if the system as a whole is to be effective. Otherwise, Canadian corporations could purchase control of foreign corporations, arrange to receive most of the assets of the company as a special dividend, and then sell the shares for the value of the remaining assets. The dividend would bear little or no Canadian tax because of the foreign tax credit or the exemption, but the loss would reduce taxable income and save Canadian tax. This tax result is clearly inappropriate since the Canadian corporation would not, in fact, have suffered an over-all loss on its investment. To avoid this consequence, it is proposed to reduce the deductible loss on such shares by reference to the dividends received from the corporation that did not bear full Canadian corporation tax.

(6.20) As noted above, the exemption privilege is susceptible to abuse. Not all foreign corporations carry on bona fide business operations. Some are merely devices of convenience to which income from other sources—dividends, interest, royalties and trans-shipment profits—may easily be diverted. The dividend exemption system would permit such income to be brought back to Canada tax-free. Even the tax-credit system would permit the Canadian tax on such income to be postponed indefinitely.

(6.21) To counter this type of tax-haven abuse, the United States now provides that when such income is channelled to a controlled foreign corporation, the U.S. controlling shareholders shall be taxed on a current basis whether or not the income is distributed to them. U.S. taxes are levied in the year in which the profits are earned rather than postponed until the profits are returned home. The government proposes to introduce provisions patterned generally on those in the United States. This proposal involves complicated and difficult law, but the problem is serious and defies easy solution.

Passive Investment Income of Controlled Foreign Corporations

A. *Definition of Passive Investment Income*

(6.20) As noted above, the exemption privilege is susceptible to abuse. Not all foreign corporations carry on bona fide business operations. Some are merely devices of convenience to which income from other sources—dividends, interest, royalties and trans-shipment profits—may easily be diverted. The dividend exemption system would permit such income to be brought back to Canada tax-free. Even the tax-credit system would permit the Canadian tax on such income to be postponed indefinitely.

(6.21) To counter this type of tax-haven abuse, the United States now provides that when such income is channelled to a controlled foreign corporation, the U.S. controlling shareholders shall be taxed on a current basis whether or not the income is distributed to them. U.S. taxes are levied in the year in which the profits are earned rather than postponed until the profits are returned home. The government proposes to introduce provisions patterned generally on those in the United States. This proposal involves complicated and difficult law, but the problem is serious and defies easy solution.

B. *Foreign Investment Income*

(6.22) At present, a Canadian individual who receives foreign investment income, and a Canadian corporation that receives foreign investment income other than a dividend from a controlled foreign corporation, include the investment income in taxable income and can deduct from the Canadian tax on that income the foreign income taxes he has paid to the government of the foreign country. The

government proposes to continue this treatment substantially unchanged. However it believes that in normal circumstances the rate of withholding tax levied on portfolio investment income flowing between countries that have a tax treaty should not exceed 15 per cent. For its part, Canada will be willing to limit its withholding tax on such income to 15 per cent. To achieve balance, it is proposed that the maximum rate of tax for which foreign tax credit would be granted on this type of income be 15 per cent. To provide time for Canada to expand its tax-treaty network, and for taxpayers to re-arrange their investments, this rule would not go into effect until 1974.

Foreign Business Profits

(6.23) The present tax treatment of the business profits and wages earned abroad by Canadian corporations or individuals is the same as that for portfolio investment income. The income is taxed as earned, and the taxpayer is entitled to a foreign tax credit for taxes paid to the government of the foreign country on that income. The government proposes to continue that treatment.

(6.24) While the government proposes to retain the existing system of taxing foreign business profits, two important changes to the foreign tax-credit provisions are appropriate. Provisions will be put forward to prevent taxpayers from reducing Canadian tax by transferring the operation of a foreign branch which has sustained losses to a foreign company in order to avoid the Canadian tax which should ordinarily be recaptured on subsequent branch profits.

(6.25) In addition, the government proposes to amend the foreign tax-credit provisions to permit the excess of foreign taxes paid over the amount creditable in a year to qualify for allowance in other years. The carry-over of the foreign tax credit is intended to alleviate the problem that arises when income is taxable abroad in a different year from that in which it is taxable in Canada.

(6.26) In its tax treaties, Canada will also be prepared to recognize the income taxes levied by political subdivisions of foreign countries on a reciprocal basis. If the foreign country is prepared to give a foreign tax credit for the income taxes levied by the provinces, Canada will agree to give a credit or a deduction, whichever is appropriate, for the taxes levied by its political subdivisions.

Foreign Branch Losses

(6.24) While the government proposes to retain the existing system of taxing foreign business profits, two important changes to the foreign tax-credit provisions are appropriate. Provisions will be put forward to prevent taxpayers from reducing Canadian tax by transferring the operation of a foreign branch which has sustained losses to a foreign company in order to avoid the Canadian tax which should ordinarily be recaptured on subsequent branch profits.

3. DEDUCTIONS FROM INCOME

Sundry Deductions from Income

A. *Child Care Expenses*

(1.33) Casts of looking after young children when both parents are working, or when there is only one parent and that parent is working, would be allowed as a deduction subject to certain conditions. This new plan is intended primarily to benefit mothers who need to work to support their families, and would be in addition to the normal exemption for children. The maximum expenses allowed would be the lower of $500 per child under age 14 or $2,000 per family.

(2.7) We propose to permit deduction of the child care expenses that face many working parents today. The problem of adequately caring for children when both parents are working, or when there is only one parent in the family and she or he is working, is both a personal and a social one. We consider it desirable on social as well as economic grounds to permit a tax deduction for child care expenses, under carefully controlled terms, in addition to the general deduction for children.

(2.8) Costs to be deducted would include baby-sitting expenses, day nursery care and, up to $15 a week, lodging paid at boarding schools and camps. Amounts would be deductible up to $500 per child under the age of 14, or $2,000 per family. The total allowed would also be no more than two-thirds of the earned income of the parent with the lower earned income; it would be necessary to ensure that in fact there is not a parent at home. Deductions would have to be supported by receipts and could not be claimed for payments for care of a child by a person claimed by a taxpayer or the taxpayer's spouse as a dependent relative.

B. *Employment Expenses*

(1.32) The government has examined the deductions individuals may claim for various costs they incur, as well as differences in treatment between taxpayers who are employed and those who carry on a business or profession. The royal commission said many employees have been over-taxed because they have been denied the deduction of almost all expenses incurred in earning wages and salaries. But millions of taxpayers are involved, and a very wide range of expenses could be related to earning their employment income. These taxpayers do not keep detailed records. The government has found no practical way to permit employees to deduct actual costs as do those carrying on a profession or other business. We propose to provide employees with a general deduction to cover expenses, in addition to certain specified deductions. The amount would be 3 per cent of employment income, up to a total of $150 a year. This could benefit more than 6,500,000 persons, the great majority of them earning less than $10,000 a year.

(2.12) As its second measure, the government proposes to make more provision in the law for the expenses legitimately incurred in earning wages or salaries. However, it has reached the conclusion that claims for expenses on the broad basis suggested by the commission would either impose record-keeping on millions of employees or deny them the ability to submit acceptable claims. It would also produce an impossible processing task in tax administration with inevitable long delays in making refunds. Consequently the government proposes that general limits be retained on expenses that can be deducted from employment income but that a general deduction be provided and somewhat greater recognition given to special situations where employees have to live for a period of time at a work site away from home.

(2.13) It is proposed to allow a general deduction for employment expenses, similar to the option proposed by the commission but with a lower maximum. The government believes these expenses are not generally as high as implied by the commission. It would be costly, and inequitable to others, to permit substantially more to be deducted by means of a formula than was normal in typical cases. Consequently it is proposed that the general deduction allowed for expenses incurred in earning employment income be 3 per cent of gross employment income up to a maximum of $150 per year.

C. *Unemployment Insurance Contributions and Benefits Received*

(1.36) The government has decided that it would make the tax system fairer if the treatment of unemployment insurance were changed to permit workers to deduct their contributions to the fund and to require them to pay tax on benefits received. Many of the benefits are received by employees with average or higher than average incomes who are unemployed for relatively short periods, and whose annual incomes equal or exceed the annual earnings of others. The higher their incomes the greater the tax benefit. It is fairer to tax them on this part of their income, as long as we permit all employees to deduct their contributions. Anyone on unemployment insurance benefits for most of the year is likely to pay little or no tax.

(2.14) The government proposes to allow unemployment insurance contributions as a deduction from income and to tax benefits received as explained in paragraph 2.22.

(2.22) The most important of these changes would make unemployment insurance benefits taxable and make employees' contributions to the Unemployment Insurance Fund deductible from income. Many employees receive unemployment insurance benefits for part of a year although they may have earned substantial other income during the rest of the year. Tax exemption for these payments is unfair to the person who earns the same total income but who must pay more tax. The higher the employee's regular income the greater the advantage of the present tax-exempt treatment of benefits.

D. *Moving Expenses*

(2.15) A deduction would be allowed for the expenses taxpayers often must incur when they move from one job to another. The expenses of moving from one residence to another in these circumstances would be deductible provided that the taxpayer moves to a location at leat 10 miles closer to his new job. The deduction would be permitted only from the income earned from working in the new locality.

E. *Charitable Donations*

(2.19) It is proposed to continue existing deductions and arrangements for charitable donations. Important improvements have been made in these arrangements in recent years. We propose to add national amateur athletic associations as prescribed by regulation to the list of eligible charitable organizations.

F. *Medical Expenses*

(2.20) Now that medical care as well as hospital care are covered by comprehensive public plans supported to a large extent by federal expenditures, it is proposed to change somewhat the basis on which medical expenses may be claimed. No expenses paid or recoverable from such public plans now are included in medical expenses for purposes of the Income Tax Act, nor any premiums paid by taxpayers toward such plans. The first provision is necessary to reflect the fact that such plans are already supported out of federal revenue; the second is essential for fairness because some provinces finance their plans largely from general revenue, which cannot be identified or allowed as a deduction, and others by premiums of various sizes. It is now proposed, as the royal commission recommended, that all medical expenditures for which a taxpayer has been reimbursed, or is entitled to be reimbursed, from an insurance or prepayment plan should not be classed as medical expenses for tax purposes. Instead premiums or contributions paid to plans other than government plans would be classed as medical expenses for this purpose. Medical expenses not recoverable from either public or private plans would continue to be deductible where they exceed 3 per cent of the taxpayer's income. One other change in the law will also be proposed to place contributions to public medical care plans on the same basis as contributions to public hospital care plans. This would provide that an employer's contributions on behalf of an employee be treated as a taxable benefit received by the employee.

G. *Entertainment Expenses*

(1.35) Various fringe benefits received by employees or by the owners of businesses would be included in income for the first time. For example, an employee or owner of a business with a business-owned car available for his personal use would be required to include a minimum amount in his taxable income unless he pays the business at least that amount for the use of the car. There are other fringe benefits whose value cannot readily be measured in the hands of the recipient; for example, the use of hunting and fishing lodges, yatchs and airplanes, the payment of social and recreational club dues, and the entertainment costs that are included in expense accounts. These costs would no longer be deductible to the employer.

(2.11) The government has considered this issue at length. It proposes two sets of measures to remedy the disparity. First, in regard to those in business and the professions, and to certain types of benefits granted by employers to senior employees, it intends to set more rigorous limits to check "expense account living". The costs of attending conventions and belonging to clubs would no longer be permitted as a charge in determining business income. The costs of yachts, hunting and fishing lodges or camps, amounts spent for tickets for games and performances, and costs of entertainment would also be excluded. Owners or employees of a business having a car or aircraft available to them for their personal use, including travel to and from home, would have to pay the business a minimum stand-by charge, or have a corresponding amount added to their personal income for tax purposes.

(5.9) Although the government believes that provision should be made for the deduction of legitimate business expenses that have not previously been deductible, it also believes that the present system permits deduction of certain types of expenses which taxpayers should be expected to meet out of tax-paid income. Consequently it is proposed that the Income Tax Act specifically deny deduction for entertainment expenses, the costs of attending or sending employees to conventions, and the cost of dues for membership in social or recreational clubs. This provision would not prohibit the expenditure of funds for these purposes, but it would ensure that taxpayers who wish to make such expenditures would do so out of after-tax dollars.

(5.10) Under the system outlined in Chapter 4, whereby shareholders are given credit for the tax paid by their corporations, merely denying a deduction for this type of expenditure is not sufficient. Although the denial of the deduction would mean that the corporation pays extra tax, the shareholders of the corporation would receive credit for the extra

tax paid. Therefore, it is necessary to provide further that, in the case of corporate taxpayers, taxes due because of the non-deductibility of these expenditures would not be creditable.

H. *Capital Expenditures not previously deductible—including Goodwill*

(5.4) There is a class of expenditure incurred by businesses that is not deductible, either in the year in which the expenditure is incurred or over a series of years. The taxpayer is prohibited from deducting them in the year in which they are incurred because they are capital expenditures. He is prohibited from deducting the cost over a number of years by way of depreciation because they do not give rise to an asset for which provision is made in the depreciation regulations. Perhaps the best known of these capital nothings is goodwill. If a Canadian buys a business, he can neither deduct nor depreciate the portion of his purchase price that relates to the goodwill of the business.

(5.5) The government proposes to create a new depreciation class which would sweep up all of these nothings and which would enable the taxpayer to deduct 10 per cent of the book value of this class each year. We believe that the 10-per-cent rate is fair if one takes into account the type of expenditure to be included.

(5.6) This proposal would be impossible without a tax on capital gains. For as long as the proceeds of the sale of goodwill, among other things, remained tax-free, it was impossible to give a deduction for the cost of purchasing goodwill without creating a leak in the tax system. This leak would cost significant amounts of revenue even under ordinary commercial practices, and the revenue loss would be greatly increased as a result of taxpayers arranging their affairs to take maximum advantage of the situation.

(5.7) The goodwill of a business has been described as the value that can be placed on the fact that customers are more likely to trade with that firm than with a new firm in the same line. This likelihood arises in part as a result of advertising and in part because customers have been satisfied in their past dealings with the firm. Clearly, goodwill is a thing that must be kept up. If a firm stops advertising or if it stops giving satisfactory service, its goodwill will disappear. Therefore, the goodwill that a firm has now is the result of its past actions, and the goodwill that it has five years from now will be the result in part of its past actions and in part of its actions in the next five years. The government proposes to recognize this fact in the treatment of taxpayers who sell goodwill in the future. The longer the period after the beginning of the new system before the sale takes place, the more of the proceeds of sale that would be taxable and the smaller the part of the proceeds that would be exempt.

(5.8) Another fact must be taken into account in setting the treatment of early sales of goodwill: purchasers would be willing to pay more for goodwill under the proposed system (since they can deduct the expenditure for tax purposes over a period of years) than they are willing to pay under the existing system. With these factors in mind, the government proposes that taxpayers who sell goodwill in the first year of the new system would be taxable on 40 per cent of the proceeds and exempt on 60 per cent; if in the second year, taxable on 45 per cent and exempt on 55 per cent; and so on, with the taxable portion increasing by 5 percentage points each year until the thirteenth year when 100 per cent of any proceeds would be taxable. Naturally, if a sale of goodwill involves a business that was not in existence when the new system commences, all of the proceeds would be taxable even though the sale takes place before 12 years have passed.

Capital Cost Allowances

A. *Review of System*

(5.14) The system has without doubt proven easy to comply with, and has caused far fewer difficulties between taxpayer and tax-gatherer than the more usual "straight-line" system that preceded it in 1948 and earlier years. One of the reasons that it works so well may be because, on balance, the rates tend to be on the generous side. This generosity has acted as an incentive to taxpayers to modernize and improve their business facilities but naturally at some cost in government revenue. The royal commission did not recommend reductions in depreciation rates. Perhaps for that reason, the rates were not generally an issue in the public debate on tax reform that has taken place over the past two years. Nevertheless some have suggested that they are too generous, and the government believes that after 20 years of the

system it is time for a review. However, depreciation is an important aspect of the tax system and taxpayers should have an opportunity to put forward their views and experience before major changes are considered. Therefore, the government intends in due course to invite briefs on the system and rates of capital cost allowance.

B. *Allowances of Buildings*

(5.16) Many taxpayers who would otherwise be in quite high tax brackets have become landlords, and have been able to reduce or eliminate the tax on their other income by claiming the maximum depreciation on their buildings. Ideally this early generosity should be offset by lower depreciation deductions in later years, or by recapture of the extra depreciation on sale. However, if the taxpayer buys additional buildings—and with the relatively low down payments required, this can often be done out of the tax savings alone—he can postpone almost indefinitely the day when his total depreciation deductions will drop below average. Moreover, since most of the buildings concerned are in the same class, a taxpayer who sells a building can avoid recapture of the proceeds by investing them in another building. Finally, if the taxpayer continues this process throughout his life, the tax postponed becomes tax saved forever. When a taxpayer dies, excess depreciation is not recaptured, and the person who inherits the buildings is entitled to depreciate the full fair market value of the buildings, no matter what net book value his predecessor had.

(5.17) The government proposes to close this loophole in three ways. First, as mentioned in Chapter 3, a person who inherits property would for tax purposes inherit the tax cost of that property to the deceased. In this case, that would mean that the inheritor starts with the same base for depreciation as the deceased had when he died. Second, a taxpayer would be prohibited from deducting from other income a loss from holding property if that loss is created by capital cost allowance. (It is also proposed that the same restriction be placed on the deductibility of losses arising from holding property if those losses are created by a deduction of interest or property taxes. Otherwise taxpayers could reduce or eliminate the tax on their current incomes by holding large amounts of speculative property.) Finally, it is proposed that a separate depreciation class be created for

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each rental building that costs $50,000 or more. This would mean that there would be a day of reckoning for the owner of each large building. As each such building is sold the taxpayer would bring back into income the amount by which depreciation deducted for tax purposes exceeds the depreciation actually suffered, or conversely he would get a deduction for tax purposes immediately if he has in fact suffered greater depreciation than he has been allowed for tax purposes.

(5.18) Because the depreciation rates are based on averages, they sometimes turn out to be inadequate. Indeed, as the royal commission pointed out, there are instances in which the net book value of a class of assets becomes greater than the cost of the assets that the taxpayer has on hand at the time. This arises, of course, because the depreciation he has been permitted was not as great as the actual depreciation suffered on some of the assets which he has since sold or scrapped. This problem would disappear in the case of rental buildings which cost more than $50,000 as explained in the previous paragraph. However, it would remain for other assets. Consequently the government proposes that taxpayers be permitted at any time to write a class of assets down to the aggregate cost of the assets of that type still on hand.

C. *Change of Control*

(5.19) The government also proposes to require corporations to make this type of write-down in any year in which control of the corporation changes hands. This proposal will help to restrict the sale of business losses.

D. *Recaptured Depreciation*

(3.54) Another example concerns taxpayers who own depreciable property that they are using for income-earning purposes. Consider the case of a taxpayer who bought an apartment building for $500,000 and has over the years claimed depreciation for tax purposes of $200,000. Under the present system if he sells the apartment building for more than $300,000, the next $200,000 is treated as a "recapture" of the depreciation he has been permitted and either directly or indirectly comes into the computation of his taxable income. Only if he sells the building for more than $500,000 will any part of the proceeds be considered a capital gain—the excess over

$500,000. The act would be drawn up in such a way as to make it clear that the taxpayer is still liable for tax on recaptured depreciation.

(4.79) To secure tax on the recapturable depreciation, it is proposed that part of the tax paid by closely-held corporations be treated as non-creditable until non-creditable tax has been collected on the amount that would have been taxable under the present system. This would of course not accomplish the objective with respect to corporations that are to be treated as partnerships. Shareholders of such corporations would have to elect to value their shares in the same manner as a proprietor or partner is to value his business assets—at values that would leave inventory profits and recapturable depreciation taxable.

Thin Capitalization

(6.42) No country has yet found a satisfactory tax solution to this "thin-capitalization" problem, although a number of other countries rely extensively on investment restrictions and currency controls to thwart abuse. The government proposes to restrict the deductibility of non-arm's-length interest wherever the ratio of shareholder debt to equity exceeds three to one. Such a provision is necessarily arbitrary and it is difficult to administer. It may have to be altered at a later date in the light of experience.

4. AVERAGING OF INCOME

(2.55) The government has reached the view that a general averaging formula should be available to all individual taxpayers. However, it proposes a much simpler and more automatic system than the royal commission did. Averaging would introduce new complications for the taxpayer, and new need for keeping records. Moreover, the system proposed by the commission would confront the taxpayer with difficult choices, and the possibility of choosing a period that would later prove to be against his own interest. The proposed simpler method can be applied automatically by the central tax assessment computer, using the information for previous years stored in its memory. Moreover, it would work smoothly and fairly even when tax rates change. It should also be noted that averaging options can be very expensive in terms of revenue, particularly at a time when incomes are growing rapidly, and there must be safeguards against giving the benefits of averaging to what are simply growing incomes.

(2.56) The method proposed is as follows: when the income in the taxation year exceeds the average of the taxpayer's income in the preceding four years by more than one-third, the excess income would be taxed as though it were subject to a graduated rate schedule in which the income brackets to which each rate applied were five times as wide as normal. The formula is necessarily complicated but this would not concern taxpayers because it can be applied on their behalf. Tables 11 and 12 show the application of the formula in more detail.

(2.57) It is not proposed to remove the present averaging formula for farmers or fishermen, who would be free to use either system. But a year included in a block of years averaged under the present system could not be used in applying the proposed new formula. Current provisions permitting averaging over a period for special lump-sum business receipts from recaptured capital cost allowance, inventory revaluation, the sale of inventory and the sale of receivables would be phased out. For corporations the phase-out would begin once the transition to one rate of corporate tax is completed. Lump-sum payments out of pension funds, or from employers on retirement, could be averaged on the new formula or, subject to certain safeguards, paid into a registered retirement savings plan, over and above the normal limit on such payments. A similar opportunity to pay extra amounts into registered retirement savings plans might be afforded to those having certain other types of irregular or short-term incomes such as authors and professional athletes. Withdrawals from such registered plans would be fully taxable and made on a regular and controlled basis.

(2.58) It would not be possible to bring the general averaging arrangement into effect immediately. It would be necessary to have the records of assessed income for previous years for all or nearly all taxpayers before the system could be fairly used. Until this accumulation of information reaches five years it would be necessary to use a shorter series of years, with a lower "threshold level".

(2.59) A second and more serious practical problem is whether years in which there is no taxable income for one reason or another should be counted for averaging, and whether

years before such a year of no income should be used. It seems unfair to permit a taxpayer to include in averaging any years in which he or she is claimed as a dependant for purposes of the married exemption. The same is true of students at school or university. Counting such years of no income, or income below the exemption limit, might well reduce tax for several years on people who have chosen to be outside the labour market and in respect of whom dependant's deductions have been granted. It is therefore proposed that a married version may use for averaging only an unbroken series of years after being claimed as a dependant by his or her marriage partner. A person under 25 years of age could use only an unbroken series of years since the last year in which he had no tax to pay. These rules are not wholly satisfactory, but no simple and practical alternative has been found. Those prevented by such rules from using more than, say, two previous years for averaging might be permitted to assume an arbitrary income of $5,000 per year in the years excluded.

5. CHANGES IN TAX RATES

Changes in Tax Rates and Simplification of Taxes

(1.24) The form of the personal income tax would be streamlined, greatly simplifying the individual's task in calculating his tax. The old age security tax and the social development tax would be merged into the graduated tax, and several other adjustments and surtaxes of recent years would be eliminated. The new graduated rates would determine the federal tax, and there would be no general abatement for provincial taxes. The provinces would be invited to apply their tax as a percentage of the federal tax, and on that basis the federal government would continue to collect this revenue for the provinces without cost to them. The Old Age Security Fund would be credited with the equivalent yield of the present old age security tax.

(1.27) The new rates of tax would replace the present graduated rates, the provincial abatements, current surtaxes, the old age security tax and the social development tax. The rates would be revised to take into account the increase in exemptions, the taxation of capital gains, and the various other changes, while still bringing in the same amount of total federal revenue and serving as a base for the same total of provincial revenues. The schedule of rates is on page 25 and subsequent tables illustrate the effects on single and married persons. When the new employment expense allowance is taken into account (see below), the amounts of tax under the new rates would be less than the present tax on single persons up to an income of about $3,400 per year, and on married persons up to an income of about $9,100. For incomes above these levels the tax would be higher than under the current law, particularly when changes in the definition of income are taken into account.

(2.30) The government therefore has decided that along with the increases in exemptions should go a significant increase in the rates applying to the taxable income remaining after all exemptions and deductions.

(2.33) The federal government wishes to avoid causing any significant change in provincial revenues through its changes in exemptions and rates. But the present complicated system must be improved. Accordingly, it is proposed to meld the basic rate schedule, the old age security tax, the social development tax, the current surtax and the 20-per-cent reduction into one new schedule of graduated rates which, when used with the increased exemptions, would produce about the same revenue as the aggregate of the present basic tax after abatement and the other taxes on income. The provincial abatement of 28 per cent would be eliminated and the provincial tax would be calculated as a percentage of the whole federal tax. To illustrate:

Present Calculation		
$100 basic tax is abated by 28 per cent to	$ 72	
Old age security tax, social development tax, 20 per cent reduction and surtax aggregate approximately	28	
Total federal tax	$100	
Provincial tax at 28 per cent of basic tax		$28
New Calculation		
Federal tax using new exemptions and rate schedule	$100	
Provincial tax at 28 per cent of federal tax		$28

(2.34) Under this new system federal tax would be abated by an additional 22 per cent for taxpayers in Quebec as part payment to the province for shared programs so their position would be unaltered. An adjustment would also be necessary for taxpayers not resident in any province. These include taxpayers in the territories and government employees living outside Canada but deemed to be residents of Canada for tax purposes. At present these taxpayers receive no provincial abatement because they are not subject to a provincial tax. Under the new proposal they would pay tax under the same new rate schedule as taxpayers in the provinces but be charged an additional tax to correspond to the provincial tax.

Abolition of 4% Surtax on Foreign Investment Income

(2.37) As part of the simplification of the rate structure the present additional tax of 4 per cent on investment income in excess of $2,400 received from sources outside Canada would be cancelled.

Cancellation of Low Rate of Tax on First $35,000 of Taxable Income

(4.30) It is therefore proposed that the low rate be removed from the business profits of small corporations gradually over a period of five years. For corporations with taxable business profits not greater than $35,000 the low rate would apply to $28,000 in the first year of transition, $21,000 in the second, $14,000 in the third, $7,000 in the fourth, and be eliminated entirely in the fifth year. For corporations with taxable business profits above $35,000, the amount subject to the low rate would be reduced more quickly the more the corporation's taxable profits exceed $35,000. The benefit would be removed immediately if taxable business profits equal or exceed $105,000. In other words, the larger the corporation the more quickly it would lose the benefit designed for small corporations.

(4.31) The precise formula would remove 80 cents of a corporation's entitlement to be taxed at the low rate for each $2 of business income in excess of $35,000 in the first year of transition. In the second year the reduction would be 60 cents for each $2; in the third year, 40 cents for each $2; and in the fourth year, 20 cents for each $2. In the meantime the maximum entitlement would be reduced, so that the effect would be a gradual reduction in the amounts subject to the low rate of tax. For example, a company with taxable business profits of $85,000 in each of the first five years of the new system would be entitled to have $8,000 taxed at the low rate in the first year, $6,000 in the second year, $4,000 in the third year, $2,000 in the fourth year and nothing the fifth year. On the other hand, a corporation that earns $45,000 in each of the first five years would be entitled to have $24,000, $18,000, $12,000, $6,000 and zero taxed at the low rates.

6. DISTRIBUTION OF DIVIDENDS

Distributions of Dividends by Closely-Held Corporations

A. *Distributions to Shareholders*

(1.39) The government proposes to alter the method of taxing corporations by establishing a single rate of corporation tax and providing a system of credits to shareholders for corporate taxes paid. An important distinction would be made between private, closely-held corporations and public, widely-held corporations.

(1.40) For closely-held corporations, which are usually smaller businesses managed by the shareholders, the tax should be related as closely as possible to rates paid by individual shareholders. There is usually a close identity between the shareholders and the corporation. These corporations usually compete in markets with unincorporated businesses subject only to personal income tax. Under the proposed plan the federal income tax paid by such corporations would be treated as a prepayment of the personal income tax on behalf of individual resident shareholders. Under certain conditions the corporation could elect to be taxed as a partnership of its shareholders. In other cases the shareholders would pay tax on a sum that includes their dividends plus a related amount of corporate tax already paid; and they would then claim credit for the corporate tax paid, and qualify for a refund if their own rates are lower than the corporate rate.

(4.24) In the case of those corporations which are not to be treated as partnerships, parity with the shareholders of partnership corporations would be achieved in two steps.

There would be a tax of 50 per cent on the taxable income of the corporation. However, when the net profits are distributed to the shareholders, credit would be given for the full amount of the tax paid by the corporation on those profits.

(4.25) An example may help to explain how this system would work. A closely-held corporation with profits of $20,000 would pay a tax of $10,000, leaving $10,000 to be distributed to the shareholders. When the corporation pays the next $10,000 in dividends, it would instruct the shareholders to report $20,000 as their income for tax purposes (the before-tax profit of the corporation) and to claim credit for the $10,000 of tax paid by the corporation. A shareholder who receives a dividend of $100 would therefore report $200 as his income from the corporation and would show on his return that $100 tax had been paid by the corporation. If his marginal tax rate is 40 per cent, the tax on the dividend would be $80 and he would be entitled to a refund from the government of the extra $20. In this way the ultimate tax on his share of the profits of the corporation would be the same as if he had received the $200 directly.

(4.26) This procedure of giving credit to the shareholder for taxes paid by the corporation would be applied both to cash dividends and to stock dividends so that the process should not by itself force private corporations to pay out in cash a higher proportion of their profits than they would under the present system. In the case of a stock dividend, the shareholder would of course not have received any cash from the corporation with which to pay his tax. However, the credit he receives for the tax paid by the corporation would cover his liability on the dividend unless his marginal tax rate exceeds 50 per cent. Therefore the system would not result in taxpayers being forced to pay tax at a time when they lack means to satisfy the tax liability.

(4.27) For the shareholder to receive credit for tax paid by a corporation, the corporation would have to pay the appropriate dividends—either cash or stock—within a limited period of time. It is proposed that tax paid with respect to a given taxation year should be creditable only if it is passed through to the shareholders within 2½ years from the end of the corporation's taxation year. This is necessary in order to limit the amount of outstanding claims against the government: if corporations accumulated creditable tax for 10 or 15 years, large dividends at the end of that time could seriously affect government revenues in the year of distribution. Further, the rule would limit the amount of creditable tax in any given corporation at any given time and so reduce the temptation to taxpayers who cannot make use of creditable tax to "sell" it to taxpayers who can make use of it.

(4.32) Taken together these proposals concerning closely-held corporations should provide a tax system with the same effect on business carried out through such a corporation as on business carried on through a proprietorship. It should also collect the same tax on the investment income of a Canadian individual whether he holds his investments directly, or whether he holds them through a personal holding corporation.

B. *Distributions to Mutual Funds*

(4.61) Open-end mutual funds and most closed-end mutual funds would be widely-held corporations under the definitions proposed earlier in this chapter. As a result shareholders would receive the dividends that flow through the mutual fund subject to the same tax as if they had received the dividends directly. There is one exception to this, in the case of dividends from a closely-held corporation that are routed through a mutual fund. In this instance the government feels it appropriate to levy the same taxes on this portion of the corporate income as if the earnings had been in a public corporation. The relationship of the shareholder of the mutual fund to his corporation is much the same as that of shareholders of other public corporations to their corporations.

(4.62) A special rule would, however, be required for mutual funds. This type of corporation must be able to put its shareholders in the same position as if they themselves had realized their proportion of the capital gain of the mutual fund arising on the sale of shares in public Canadian corporations. In the absence of a special provision mutual fund shareholders would pay tax on the full amount of such gains when they were distributed to them, whereas tax should be applied only to half of the gain. Consequently, this type of corporation would be enabled to make special distributions to its shareholders which would be treated as though they were a capital gain on the sale of a Canadian public corporation. The effect of this proposal is illustrated below:

	Mutual Fund	Individual Shareholder
Gain on sale of shares	$300	$300
Tax:		
At $33\frac{1}{3}\%$ on the gain	100	
At say 40% on one-half of the gain		60
Net gain	200	
Special dividend distributed to shareholders	200	
Taxable credit	100	
Taxable amount	300	
Gross tax, at 40% on one-half	60	
Less credit	100	
Refund	40	
Net amount retained		
Dividend plus refund	$240	
Gain less tax		$240

C. *Recaptured Depreciation*

(4.79) To secure tax on the recapturable depreciation, it is proposed that part of the tax paid by closely-held corporations be treated as non-creditable until non-creditable tax has been collected on the amount that would have been taxable under the present system. This would of course not accomplish the objective with respect to corporations that are to be treated as partnerships. Shareholders of such corporations would have to elect to value their shares in the same manner as a proprietor or partner is to value his business assets—at values that would leave inventory profits and recapturable depreciation taxable.

Distribution of Dividends by Widely-Held Corporations

A. *Credit for Canadian taxes paid by Corporation*

(1.42) Widely-held corporations are usually larger businesses where the link between shareholders and management is tenuous. Such corporations are themselves important economic entities. Their products or services are usually sold in competition with other large corporations, where prices yield an adequate return after paying corporate tax. One half the corporate income tax paid by such corporations would be regarded as a prepayment of individual tax for individual Canadian resident shareholders, but the other half would not be linked in this way. Shareholders receiving dividends from profits taxed under the new plan would be liable for tax on the dividend plus an amount of "creditable tax" "equal to half the dividend and would be given credit for that amount of tax. This system would be roughly equivalent to the present dividend tax credit for taxpayers in the 50-per-cent tax bracket and would be more favorable for those in lower tax brackets. It would thus provide a powerful incentive for investment by Canadians in Canadian corporations.

(4.36) However, the government does want to reform the dividend tax credit. It proposes to replace the existing credit with a system giving Canadian shareholders credit for one-half the Canadian corporation tax paid by the corporation on the profits from which the dividend is paid.

(4.37) Again, an example may help to explain how the system would work. A Canadian public corporation with profits of $1,000,000 would pay a tax of $500,000, leaving $500,000 available for distribution to the shareholders. If it pays the $500,000 out in dividends, it would instruct the shareholders to report $750,000 as their income for tax purposes and to claim credit for $250,000 of the $500,000 of corporate tax paid by the corporation. A shareholder who receives a dividend of $100 would therefore report $150 as the income from the corporation and would show on his return that $50 tax had been paid by the corporation, $40 federal and $10 provincial. If his marginal tax rate is 40 per cent, the tax on the dividend would be $60 and he would owe the governments $10. If his marginal tax rate is less than one-third he would be entitled to a refund. As in the case of closely-held corporations, this procedure would be applied both to cash dividends and to stock dividends so that the process should not by itself force corporations to pay out in cash a higher proportion of their profits than they would under the present system. Also, as in the case of closely-held corporations, the credit would only be given if the corporation declares these dividends within the time limits prescribed.

(4.39) It would also mean that credit is given only for taxes actually paid to Canada so that the incentive would be limited to a forgiveness of tax and would not involve a net payment from the Canadian treasury.

B. *Credit for Foreign Taxes paid by Corporation*

(4.40) While credit would not be given for foreign corporation taxes paid, it is proposed that corporations receiving income from other countries be enabled to pass through to their shareholders credit for 15 percentage points of withholding tax levied by those foreign countries on the income received. This would provide neutrality between those taxpayers who receive foreign investment income directly and those other taxpayers who receive it through a Canadian corporation. It would also, to a substantial extent, offset the loss of the dividend tax credit for shareholders of those corporations. This provision is explained in more detail in Chapter 6.

C. *Definition of Widely-Held Corporation*

(4.43) These proposals obviously put considerable importance on the distinction to be drawn between closely-held Canadian corporations and widely-held Canadian corporations. The rules proposed for defining a widely-held corporation are as follows:

(1) All corporations with shares listed on a prescribed Canadian stock exchange on the day the White Paper is published would be deemed to be widely-held corporations.

(2) All corporations which subsequently list their shares on these exchanges would become widely-held corporations on the day on which their shares are so listed.

(3) Corporations which can meet specified tests concerning the number of shareholders and the number of shares held by those shareholders could elect to be classified as widely-held corporations.

(4) The Minister of National Revenue would have the power to designate other corporations as widely-held corporations if they meet certain tests relating to number of shareholders, dispersal of shares and public trading in shares. (In practice this would mean that most corporations with shares traded "over the counter" would be classified as widely-held corporations.)

(5) Once a corporation is classified as a widely-held corporation it would always remain a widely-held corporation. Only corporations incorporated in Canada would be eligible to be treated as Canadian widely-held corporations.

(4.44) From the time a corporation becomes a widely-held corporation shareholders would receive credit for only half the tax paid by the corporation. Any creditable tax on hand at the time of transition would effectively be cut in half.

(4.45) Proceeds from the sale of a share of such a corporation after it becomes a widely-held corporation would be taken into income for tax purposes to the extent of 50 per cent, even though part of the increase in value may well have occurred while the corporation was a closely-held corporation. This provision reflects the expectation that closely-held corporations would distribute—either by cash dividend or stock dividend—almost all of their profits to their shareholders, and that the accruing capital gain, if any, on such shares would therefore relate almost entirely to the expectation that the corporation would be able to earn greater profits in future. Because the shareholders would receive credit for only half of the corporation tax paid on these future profits, it is reasonable that the government collect tax only at half rates on the sale of those future profits.

Distributions to Non-Resident Shareholders

(4.49) The government does not propose to give foreign shareholders of Canadian corporations credit for the tax paid by those corporations. The principal reason for this decision is that the credit to Canadians in respect of corporations that compete in the international area would be given as an incentive to induce Canadians to purchase shares in these corporations. While the government welcomes foreign investment in Canadian corporations, it does not believe it is necessary to subsidize non-residents through the tax system in order to induce them to invest their capital in Canada. Canadian resources, labor and management can compete on even terms for capital with their counterparts in other countries. Because the general tax rule in other countries does not include a credit to the shareholder in respect of taxes paid by the corporation, it is not necessary for Canada to enact such a provision, and it would be quite expensive to do so; an expense that would have to be borne by the Canadian taxpayers.

Distributions to Mutual Funds

(4.61) Open-end mutual funds and most closed-end mutual funds would be widely-held corporations under the definitions proposed earlier in this chapter. As a result

shareholders would receive the dividends that flow though the mutual fund subject to the same tax as if they had received the dividends directly. There is one exception to this, in the case of dividends from a closely-held corporation that are routed through a mutual fund. In this instance the government feels it appropriate to levy the same taxes on this portion of the corporate income as if the earnings had been in a public corporation. The relationship of the shareholder of the mutual fund to his corporation is much the same as that of shareholders of other public corporations to their corporations.

Distribution of Dividends by Foreign Corporations

A. *Individual Shareholders*

(4.46) The government does not propose to give individuals who hold shares in foreign corporations credit for the corporate tax paid by those corporations. For the most part, the investment that a Canadian can make in a foreign corporation will be in a public corporation or in a corporation large enough to compete with public corporations. Therefore the pricing and profit structure of the corporation will contemplate the payment of a corporation tax. And of course the government has no desire to provide an incentive to Canadians to invest in foreign corporations: it does not intend to put barriers in the way of their doing so but it does not want to provide a tax incentive to induce them to do so. Further, must foreign countries have a corporation tax which is separate from the personal income tax and do not give a credit to shareholders in respect of the corporation tax paid by the corporation. If Canada were to give a credit for the corporation tax paid in that country, it would be giving Canadians an advantage over the residents of the country in the business enterprises of that country. Finally, it is one thing to forgo taxes to accomplish a given purpose. This is what is being done with respect to Canadian shareholders of Canadian corporations. It is a quite different thing to make payments to people in respect of taxes paid to other countries: this would represent a net drain on the Canadian treasury.

B. *Canadian Corporate Shareholders—Portfolio Investments*

(4.47) The government does not propose to give Canaidan corporations which have a portfolio investment in foreign corporations credit for the tax paid by those corporations on the profits out of which they pay their dividends. These corporations stand in the same relationship to these foreign corporations as does the individual Canadian shareholder to the widely-held Canadian corporation in which he invests, and the government does not wish to provide a tax incentive in Canadian corporations to make portfolio investments abroad. As previously mentioned, it does propose to provide Canadian corporations with a mechanism by which they can pass through to their shareholders the withholding tax that they suffer on dividends received from foreign investments. This provision, which would provide neutrality with individuals who hold their foreign investments directly, is described in more detail in Chaper 6.

C. *Canadian Corporate Shareholders—Controlling interest in foreign corporations*

(4.48) The government does propose, however, to grant to Canadian corporations which have a controlling interest in foreign corporations, credit for the corporate taxes paid by those foreign corporations. These Canadian corporations stand in the same relationship to their foreign controlled corporations as does the Canadian individual shareholder to the closely-held Canadian corporation in which he has an interest. Again, this proposal is outlined in greater detail in Chapter 6.

Allowance for Foreign Taxes Withheld from Dividends

(6.27) Most countries levy a flat-rate withholding tax on dividends paid by corporations in the country to non-resident shareholders. Canada does so at present, and proposes to continue to do so. As previously explained, when a foreign dividend is received by a Canadian individual, he would get a credit against his Canadian income tax for the foreign withholding tax up to a maximum of 15 per cent. If, however, the Canadian individual invests in a Canadian corporation (say a mutual fund) which owns shares in a foreign corporation, he would not receive a credit for the foreign withholding tax. At present a rough balance is struck since the dividends of the Canadian corporation are eligible for dividend tax credit even though they come from profits that did not bear full Canadian corporate tax. With the proposed more precise and somewhat larger credit for corporation taxes described in Chapter 4, it is

no longer feasible to deal with the withholding tax in this rough and ready way.

(6.28) The withholding tax on dividends also causes problems for Canadian corporations which have both foreign subsidiary corporations and foreign shareholders. When a foreign subsidiary corporation pays a dividend to the Canadian parent corporation, there is a withholding tax. When the parent corporation uses those funds to pay dividends to its shareholders, there is another withholding tax on the dividends paid to its foreign shareholders. If a foreign shareholder happens to be in the same country as the foreign subsidiary corporation, there are two withholding taxes paid to move profits earned in his country to Canada and then back again. In some groups of corporations, profits can cross three, four or more international borders before they reach the final individual shareholders.

(6.29) The government hopes to alleviate both of these problems by allowing 15 percentage points of the foreign withholding tax to pass through the Canadian corporation and to qualify for credit treatment in hands of the final shareholder. An example will help to explain this "flow-through" proposal. Assume a Canadian corporation receives a dividend of $100 less $15 from a subsidiary company incorporated abroad. Under the existing provisions the Canadian parent company could pay out the $85 received to its shareholders. A resident individual would reflect the $85 dividend in his income and pay tax at his ordinary personal rates. A foreign shareholder would receive a net dividend of $72.25 ($85, less 15-per-cent Canadian withholding tax). Under the "flow-through" proposal, the company would be in a position to declare a dividend of $100 and to recoup the foreign tax by "deducting" $15 from this amount. The resident shareholder would report dividend income of $100 and claim credit for the $15 tax withheld. In the same way the non-resident shareholder would be entitled to a $100 dividend from which the $15 tax had been deducted.

(6.30) The "flow-through" privilege would apply to the foreign tax imposed on all foreign dividends. To place foreign branches and subsidiaries on the same general footing, the privilege would also apply to a portion of the foreign tax imposed on branch profits abroad. The amount qualifying for flow-through treatment would be limited in all circumstances to the lesser of (a) the foreign tax, or (b) 15/85ths of the foreign earnings net of all foreign taxes, including withholding tax.

Distributions of Dividends by Foreign Corporations Operating in Canada

(4.66) The present dividend tax credit applies to dividends received from taxable Canadian corporations. This phrase can cover all corporations resident in Canada whether or not they are incorporated under Canadian laws. As part of its program to improve the effectiveness of the tax system, the government proposes to remove some of the distinctions now made between corporations on the basis of residence and to distinguish instead on the basis of the place of incorporation. (It is possible for foreign corporations to move out of Canadian jurisdiction entirely. This type of manoeuvre is not open to corporations created under Canadian law.) Under the new proposals, the system of credits for corporate tax would apply only to corporations incorporated in Canada.

(4.67) This provision could mean a substantial change to some foreign corporations which now are resident in Canada and whose dividends now qualify for the dividend tax credit. Consequently it is proposed that dividends from these corporations be treated the same as dividends from Canadian corporations for a temporary period of five years in order to give them time to rearrange their affairs to conform with the new tax laws.

Dividends Paid by a Canadian Corporation to Another Canadian Corporation

A. *Where shareholder is a closely-held Corporation*

(4.55) The government proposes to restrict the credit to shareholders of Canadian corporations by reference to the Canadian corporate tax actually paid by their corporations. To do this the government must have a more exact method of passing credit for Canadian corporate tax through a chain of corporations. Moreover, the decision to tax capital gains on disposal of shares requires that a more precise method be found for giving credit for corporate tax. Otherwise corporate shareholders could choose to receive tax-free dividends and then to sell their shares, thereby avoiding entirely the tax which would otherwise have been levied on the gain realized on the sale of their shares.

(4.56) A closely-held Canadian corporation would be treated in exactly the same manner as would an individual shareholder in receiving credit for corporate tax. Specifically, it would take into its taxable income both the dividend and the taxable credit, and would claim the creditable tax as a deduction against the corporate tax which it would otherwise pay. The following table illustrates how this system would work.

Dividend received:		
From another closely-held Caandian corporation	$100	
From a widely-held Canadian corporation		$100
Plus taxable credit	100	50
Taxable amount	200	150
Gross tax	100	75
Less credit	100	50
Net tax	0	25
Amount available for distribution to its shareholders (dividend minus net tax)	100	75
Creditable tax available (gross tax amount)	$100	$ 75

B. *Where Shareholder is a widely-held Corporation receiving dividends from a closely-held Corporation*

(4.57) A widely-held Canadian corporation receiving a dividend from a closely-held Canadian corporation would be taxed on the dividend in the same way that it is taxed on other income. Specifically, the corporation receiving a dividend of $100 from a closely-held Canadian corporation would take into its income for tax purposes $200 and claim as a deduction from the corporate tax it would otherwise pay the $100 corporation tax paid by the first corporation. In effect the dividend would have been received tax-free in this situation. However, if the corporation that pays the dividend has not paid sufficient corporation tax to Canadian governments to cover the dividend, the receiving corporation would have some net tax to pay.

(4.58) When the receiving corporation pays a dividend to its shareholders it would instruct them to add to the dividend for purposes of the tax calculation only half of the corporation tax levied on it. The schedule set out below illustrates this procedure. The effect is that shareholders of Canadian public corporations receive credit for half, and only for half, of the corporation tax paid on the profits from which their corporation pays its dividends. This is true whether the profits are earned in a subsidiary corporation or in the public corporation itself.

Dividend received	$100	$100
Plus taxable credit:		
Assuming the payor corporation had enough creditable tax	100	80
Assuming that it did not have enough, say $\frac{4}{5}$ths		80
Taxable amount	200	180
Gross tax	100	90
Less credit	100	80
Net tax	0	10
Amount available for distribution to its shareholders (dividend minus net tax)	100	90
Creditable tax available (half of gross tax amount)	$ 50	$ 45

C. *Where Shareholder is a Canadian public company receivng dividends from another Canadian public company*

(4.59) Special rules are needed to cover the case of a public corporation which receives a dividend from another public corporation. If the dividend were taxable at normal corporate rates, the effect would be to collect more corporate tax in those instances where there are inter-corporate holdings than in those instances where the individual shareholder holds his share in the operating corporation in his own name. To overcome this shortcoming it is proposed that a special tax rate be applied to the dividends received by Canadian public corporations from other Canadian public corporations. The rate would be 33$\frac{1}{3}$ per cent so that this type of inter-corporate dividend would be tax-free provided the corporation paying the dividend had paid sufficient Canadian corporate tax to cover the dividend.

This special rate would also be applied to capital gains realized by one Canadian public corporation on the sale of shares in another Canadian public corporation. Finally, the loss suffered by one Canadian public corporation on the sale of a share in another Canadian public corporation would reduce tax only at this special rate. The effect of this rate on dividends passing through an inter-corporate chain is illustrated in the following schedule:

	Corporate Chain	Direct Ownership
Dividend paid by public corporation No. 1	$100	$100
Public corporation No. 2		
Dividend received	100	
Plus taxable credit	50	
Taxable amount	150	
Gross tax, at $33\frac{1}{3}\%$	50	
Less credit	50	
Net tax	0	
Amount available for distribution	100	
Creditable tax (gross tax amount)	$ 50	
Individual shareholder		
Dividend received	$100	$100
Taxable credit	$ 50	$ 50

Distribution of Dividends by Electric, Gas or Steam Utilities

(4.63) In 1966, Parliament passed the Public Utilities Income Tax Transfer Act under which the Minister of Finance turns over to the provincial governments 95 per cent of the corporation tax collected from certain electric, steam and gas utility corporations.

(4.64) The whole scheme of the present proposals contemplates that shareholders of Canadian corporations receive a credit from the federal government for part or all of the federal corporation tax paid by their corporation. It would be contrary to this general scheme if the federal government gave to shareholders of these utility corporations credit for taxes which the federal government has turned over to the provincial governments, and it does not propose to do so.

(4.65) It would be possible to give the shareholders credit for the taxes which the federal government retains. However, the amounts would be very small and the government considers it more efficient to ask Parliament to amend the Public Utilities Income Tax Transfer Act so that all of these taxes are turned over to the provinces, who could then decide to what extent they should be turned over to the corporation or its shareholders.

7. CORPORATE PARTNERSHIPS

A. *Election*

(4.20) The objective of the proposals for closely-held corporations is to put them as nearly as possible in the same tax position as their competitors. In other words, to design a system that will produce the same tax on a Canadian whether he carries on his business in his own name or whether he incorporates it.

(4.21) This objective will best be achieved in those instances in which the corporation can elect to be taxed as a partnership. Under this option, the corporation would not pay any corporation tax at all, but each shareholder would pay personal tax each year on his share of the corporation's profits.

(4.22) If this rule were applied to all closely-held corporations, there would be instances in which shareholders who own a few shares in the corporation would be forced to pay tax when they do not receive any income from the corporation, and have no means at their disposal to force the corporation to declare dividends to provide cash with which to pay the tax. Consequently it is proposed that this "partnership option" be available only in those instances in which all shareholders sign an election that the corporation's profits be taxed in this manner.

(4.23) For technical reasons, three restrictions must be imposed on corporations that can be treated as partnerships. First, it must be clear what portion of the profits each shareholder is going to receive. This would usually mean that the corporation can have only one class of shares, although there may be instances in which the respective rights of different classes of shareholders would be unchanged by differing future circumstances,

including winding up the corporation. Secondly, all shareholders must be individuals resident in Canada or corporations incorporated in Canada. If the profits are to be taxed according to the circumstances of the shareholder, the government must be able to determine what those circumstances are, and whether the person in whose name the shares are registered is in fact the owner of the shares and not a nominee. Finally, if some shares are held by Canadian corporations, those corporations must have the same fiscal year-end as the corporation itself. In the absence of this year-end rule, it would be possible to postpone tax for several years by using a chain of corporations with appropriate year-ends.

(4.32) Taken together these proposals concerning closely-held corporations should provide a tax system with the same effect on business carried out through such a corporation as on business carried on through a proprietorship. It should also collect the same tax on the investment income of a Canadian individual whether he holds his investments directly, or whether he holds them through a personal holding corporation.

B. *Recaptured Depreciation*

(4.79) To secure tax on the recapturable depreciation, it is proposed that part of the tax paid by closely-held corporations be treated as non-creditable until non-creditable tax has been collected on the amount that would have been taxable under the present system. This would of course not accomplish the objective with respect to corporations that are to be treated as partnerships. Shareholders of such corporations would have to elect to value their shares in the same manner as a proprietor or partner is to value his business assets—at values that would leave inventory profits and recapturable depreciation taxable.

8. MINING COMPANIES AND OIL AND GAS COMPANIES

A. *Exploration and development Costs*

(1.50) The government has decided that some special rules should still apply in determining the income derived from the mineral industries, in order to encourage exploration for and development of mineral deposits. These inducements are intended to encourage the establishment and growth of highly productive industry in areas of Canada outside those where rapid urban and industrial growth are already occurring. However, the special rules should be revised substantially to ensure that really profitable projects pay a fair share of the national revenues, as other industries do, and that the inducements offered are efficient.

(1.51) Two main changes are proposed. The first would replace the three-year tax exemption for new mines with a special rule permitting capital costs of fixed assets purchased for the development and operation of a new mine to be charged off against income from that mine as quickly as desired. This change would take effect in 1974 at the expiration of the period for which the government in 1967 gave assurances that the three-year exemption would continue. The new rule would ensure that in the high-risk business of mining, taxes would not be paid until investments in new projects are recovered, but it would do so on a more economical basis than the present exemption.

(1.52) The second change concerns depletion allowances. The existing maximums would continue to apply—generally no more than one-third of production profits—but a taxpayer could run out of depletion allowances unless he continues to explore for, and/or develop, Canadian minerals. Every $3 of qualifying expenditures made after this White Paper is published would "earn" the taxpayer the right to $1 of depletion allowances if and when his production profits permit. Depletion allowances on new properties would have to be "earned depletion" immediately: "unearned" allowances would be continued for five years on existing properties as a transitional measure. This proposal is more fully explained in Chapter 5. That chapter also sets out other changes of detail applying to the mineral industry. They flow mainly from other more general changes proposed in the tax system.

(5.25) The present rules concerning exploration and development costs accomplish the objective set out in the preceding paragraph: the costs of mineral exploration and development can be deducted for tax purposes early enough so that taxes will be applied only when it is clear that a project will be profitable. Under these rules, a corporation which has as its principal business either mining, the production of oil, or certain allied activities (refining and/or distributing petroleum or petroleum products, fabricating metals or operating pipelines), may deduct Canadian exploration and development costs as they are

incurred. If these costs exceed the corporation's income, then it may deduct the balance of the costs in the first subsequent year in which it has enough income.

(5.26) Other taxpayers may also deduct exploration and development costs as they are incurred, but if they do not meet the principal business test mentioned above, they may deduct them only from income from mineral properties. This rule has guaranteed that tax was not paid until these costs were recovered, but it has meant that taxpayers who were unsuccessful in their mineral projects have suffered losses that were not deductible for tax purposes. To cure this defect, it is proposed that taxpayers who fail to meet the principal business test be entitled to put their future exploration and development expenses in an asset class and to deduct annually part or all of their accumulated undeducted expenses up to a maximum of the greater of two amounts:

(1) their income from mineral properties before any deduction in respect of exploration and development expenses,

or

(2) 20 per cent of the net book value of the class.

For this purpose, income from mineral properties would include producing profits, royalties received, and the proceeds of the sale of mineral rights.

B. *Purchase and Sale of Rights and Leases*

(5.27) Since 1962, the cost of acquiring oil rights or natural gas rights has been included in the definition of exploration and development expenses. Consequently these costs have been deductible for tax purposes within the limits of the rules relating to exploration and development expenses. It is proposed that this rule be retained, and that it be expanded to cover the costs of other mineral rights.

(5.28) Also since 1962, the proceeds of sale of oil rights and natural gas rights have been treated as taxable income. As part of the proposal to tax capital gains, this rule would also be extended to apply to all mineral rights. A special rule would be applied to the proceeds of the sale of rights which are held on the day this White Paper is published if the proceeds of the sale of those rights would not have been income for tax purposes under the existing rules. This special, transitional rule is similar to that proposed in paragraph 5.8 with respect to existing goodwill; if the sale is in the first year of the new system, only 60 per cent of the proceeds would be taken into account; if in the second year, 65 per cent; the third year 70 per cent; and so on, increasing by 5 per cent each year until all of the proceeds are taken into income if the sale is in the ninth or a subsequent year. Since the cost of these rights would henceforth be deductible for tax purposes, prices should rise and this system should produce a fair after-tax return to the present owners.

C. *New Mines*

(5.29) In addition to their exploration and development expenditures, mining corporations spend large sums of money on mining machinery and buildings before they know whether their new mine will be profitable. In order to recognize this risk, the government proposes to put depreciable assets of this type acquired for production from a particular new mine in a separate asset class and to permit the taxpayer to write them off for tax purposes just as fast as he has enough income from the new mine to absorb the charge. The assets concerned are those described in paragraphs (g) and (k) of class 10, which read as follows:

"(g) a building acquired for the purpose of gaining or producing income from a mine (except an office building that is not situated on the mine property and a refinery)

"(k) mining machinery and equipment acquired for the purpose of gaining or producing income from a mine."

(5.30) This provision would not replace the existing right to deduct 30 per cent of the net book value of assets in this class: it would supplement it. If the new mine produces sufficient profit to absorb a deduction of more than 30 per cent, the taxpayer could make that deduction. If it does not, he could nevertheless deduct up to 30 per cent if he chooses. thereby either reducing other income or producing a business loss which could be offset against income in other years.

(5.31) Once the provisions concerning exploration and development costs, the costs of acquiring mineral rights, and the costs of mining machinery and buildings are in place, taxpayers can be pretty well assured that they would not be taxed on mining ventures until after they recover their investment. Having provided that assurance, the government proposes to phase out the present three-year exemption for new mines.

(5.35) The present three-year exemption would continue to apply until December 31, 1973, in accordance with the announcement made by the then Minister of Finance in May, 1967. New mines which have come into production in commercial quantities before the publication of this White Paper would be eligible for the exemption but would not be able to take advantage of the new proposal concerning fast write-off. New mines which come into production after the publication of this White Paper but before January 1, 1974 would be entitled to elect to take advantage of either incentive but not both. Specifically, they would be entitled to claim exemption of the profits earned either in the first three years of operation or in the period remaining to January 1, 1974, if that is shorter. At the end of the exempt period they would be entitled to the fast write-off of the capital cost of their mine assets, but only if they reduce the book value of those assets by the full amount of their exempt profits.

D. *Percentage Depletion—Operators*

(5.36) At present, the act provides that operators of mineral resources, and this phrase includes oil and gas wells, are entitled to reduce their taxable income by claiming depletion allowances. For the most part these depletion allowances are calculated as a percentage of the profits derived from production from the mineral resource, and the usual percentage is 33⅓ per cent. Special rates of depletion are provided for gold and for coal.

(5.40) The government believes that both of these inefficiencies can be substantially reduced if depletion allowances are more directly related to the activities which it is desired to affect. Consequently it is proposed that, after a suitable transitional period in respect of mineral rights held by the taxpayer on the day this White Paper is published, depletion allowances would have to be "earned". The existing maximums would continue to apply—that is, generally no more than ⅓ of production profits—but a taxpayer could only deduct these maximums, or any amount, if he spends enough on exploration for or development of mineral deposits in Canada or on those fixed assets described in paragraph 5.29 that are acquired for the exploitation of a new Canadian mine. The formula proposed is that for every $3 of eligible expenditures made after this White Paper is published a taxpayer would earn the right to $1 of depletion allowance. If his profits that year are not sufficient to permit him to deduct the amount earned, he could carry the undeducted amount over to subsequent years. The cost of acquiring mineral rights would not be an eligible expenditure for this purpose.

(5.41) Under the proposed system, a taxpayer could run out of depletion allowances unless he continues to explore for, and/or develop, Canadian minerals. Once the system is fully effective, a taxpayer's allowances would end when his profits before "eligible expenditures" exceed twice the amount of those expenditures. Consider the following example:

Profits for eligible expenditures	$6,003
Deduct eligible expenditures	3,000
	3,003
Maximum depletion $1,001 (⅓ of $3,003)	
Earned depletion (⅓ of $3,000)	1,000
Taxable income	$2,003

(5.42) The system would not become fully effective immediately. The government proposes that for the first five years of the new system taxpayers be entitled to depletion allowances in respect of production profits from properties they now own without having to "earn" them. This period, combined with the entitlements to the earned allowances that taxpayers would be able to accumulate between the publication of this White Paper and the end of 1975, should enable the mineral industries to make a smooth transition to the new system.

E. *Percentage Depletion—Non-Operators*

(5.43) Under the present legislation a depletion allowance of 25 per cent may be deducted by non-operators from their income from mineral properties. This provision applies principally to the holders of royalties. The concession sought to recognize that royalties might well in part be a return of capital. This fact would under the present proposals be more accurately recognized by the proposed rules concerning the amortization of the cost of acquiring mineral rights. Therefore it is proposed that the percentage depletion at present available to non-operators be repealed.

F. *Shareholders' Depletion*

(5.44) Also, under the present legislation a depletion allowance of 10 per cent, 15 per

cent or 20 per cent may be deducted from dividends received from a mining or oil company, the percentage depending upon the proportion of the income of the corporation which is derived from production. This concession was meant to recognize that the corporation might in fact be paying dividends out of capital. Under the new system this fact would be more accurately recognized by the deduction granted to taxpayers for losses realized on shares which they have held. Therefore it is proposed that shareholders depletion be removed.

9. FOREIGN BUSINESS CORPORATIONS

(6.33) It is repugnant in principle to have a special status for some corporations when others which are identical in every other respect cannot qualify. Moreover, the status granted is inconsistent with the provisions proposed concerning passive foreign income of controlled foreign corporations. (Foreign business corporations could receive investment income tax-free, but controlled foreign corporations would not be permitted to do so.) The government therefore proposes to withdraw the exemption. It would be withdrawn immediately with respect to "passive income", but would be transferred to a foreign tax-credit system over a period of five years for business profits. This would give existing corporations an opportunity to rearrange their affairs. Many would likely be able to avoid double tax by qualifying their foreign operations in controlled foreign corporations.

10. SUNDRY PROVISIONS

Pension Plans

(2.50) While it is difficult to work out, the government believes in principle that such a system should be established. Unfortunately it is estimated that removal of the contribution limits would be quite expensive, and revenue considerations prohibit a switch at this time. Consequently we propose to retain the existing limits based on contributions, for the present, except for certain types of specified lump-sum payments into registered retirement savings plans. We also propose that plans that are primarily for the benefit of shareholders be denied registration until the switch is made to a benefit limit. The present contribution limits should be sufficient over a period to produce, along with the Canada Pension Plan and the old age security pension, reasonable retirement incomes. We suggest that any limits, whether on contributions or benefits, should be reviewed, perhaps every five years, to see that they are in reasonable accord with changing circumstances and prospects.

(2.51) Most pension funds now are subject to regulation under the Pension Benefits Standards Acts of the provinces or of Canada. These control the investments of pension funds in a manner generally adequate for tax purposes. However, it is essential to be sure that tax-free funds cannot be diverted through investment in such a way as to bring current benefits to those who contribute to them and control them, and to provide sanctions to be applied when investments are made contrary to the rules. With adjustment to meet these two points it is proposed that the rules applying to investment of pension funds be the same as under the provincial and federal laws respecting pension plans. For registered retirement savings plans the permitted range of investments could be somewhat broader.

(2.52) Three other changes are also proposed. First, the savings withdrawn from these plans would be taxed at ordinary rates, even if the amounts are withdrawn at the death of the contributor. A widow would be permitted to offset or reduce this income if she contributes all or part of the proceeds to a registered retirement savings plan of her own. Second, rules are required to ensure that the trustees of a pension or retirement plan fund are liable and responsible for paying taxes arising out of its operations. This would be necessary if, for example, beneficiaries leave Canada with the assets. Third, in view of the size and rate of growth of pension and retirement savings funds, due in part to their tax-free status, it is reasonable to require that the bulk of them be productively invested in Canada. Consequently it is proposed that to qualify for the tax-free status of registered pension plans or registered retirement savings plans, these plans must invest no more than 10 per cent of their assets in foreign securities or other foreign investments.

(2.57) It is not proposed to remove the present averaging formula for farmers or fishermen, who would be free to use either system. But a year included in a block of years averaged under the present system could not be used in applying the proposed new formula. Current provisions permitting averaging over a period for special lump-sum business receipts from recaptured capital cost

allowance, inventory revaluation, the sale of inventory and the sale of receivables would be phased out. For corporations the phase-out would begin once the transition to one rate of corporate tax is complete. Lump-sum payments out of pension funds, or from employers on retirement, could be averaged on the new formula or, subject to certain safeguards, paid into a registered retirement savings plan, over and above the normal limit on such payments. A similar opportunity to pay extra amounts into registered retirement savings plans might be afforded to those having certain other types of irregular or short-term incomes such as authors and professional athletes. Withdrawals from such registered plans would be fully taxable and made on a regular and controlled basis.

(4.60) The government does not propose a refund to pension plans and other tax-free entities of the corporate tax paid by the corporations from which they receive their dividends. It considers that tax-free status of the investment income of the pension plan, including capital gains, is sufficient tax concession to these entities.

Registered Retirement Savings Plans

(2.57) It is not proposed to remove the present averaging formula for farmers or fishermen, who would be free to use either system. But a year included in a block of years averaged under the present system could not be used in applying the proposed new formula. Current provisions permitting averaging over a period for special lump-sum business receipts from recaptured capital cost allowance, inventory revaluation, the sale of inventory and the sale of receivables would be phased out. For corporations the phase-out would begin once the transition to one rate of corporate tax is complete. Lump-sum payments out of pension funds, or from employers on retirement, could be averaged on the new formula or, subject to certain safeguards, paid into a registered retirement savings plan, over and above the normal limit on such payments. A similar opportunity to pay extra amounts into registered retirement savings plans might be afforded to those having certain other types of irregular or short-term incomes such as authors and professional athletes. Withdrawals from such registered plans would be fully taxable and made on a regular and controlled basis.

Special Provisions Relating to Recaptured Capital Cost Allowances, Sale of Inventories and of Accounts Receivable

(2.57) It is not proposed to remove the present averaging formula for farmers or fishermen, who would be free to use either system. But a year included in a block of years averaged under the present system could not be used in applying the proposed new formula. Current provisions permitting averaging over a period for special lump-sum business receipts from recaptured capital cost allowance, inventory revaluation, the sale of inventory and the sale of receivables would be phased out. For corporations the phase-out would begin once the transition to one rate of corporate tax is complete. Lump-sum payments out of pension funds, or from employers on retirement, could be averaged on the new formula or, subject to certain safeguards, paid into a registered retirement savings plan, over and above the normal limit on such payments. A similar opportunity to pay extra amounts into registered retirement savings plans might be afforded to those having certain other types of irregular or short-term incomes such as authors and professional athletes. Withdrawals from such registered plans would be fully taxable and made on a regular and controlled basis.

Investment Income of Non-Profit Organizations

(5.54) The present law contains a provision—section 62(1)(i)—that exempts from income tax social, recreational and service clubs, societies and associations which operate on a non-profit basis. (This provision does not cover registered charities which are exempted under other paragraphs.) The government does not propose to change the exempt status of the basic functions of these organizations, but when they accumulate investment portfolios, it believes that the investment income therefrom should bear income tax. Therefore it is proposed that the investment income of organizations which are covered by section 62(1)(i) be subjected to the corporation tax.

(4.60) The government does not propose a refund to pension plans and other tax-free entities of the corporate tax paid by the corporations from which they receive their dividends. It considers that tax-free status of the investment income of the pension plan, including capital gains, is sufficient tax concession to these entities.

Co-operative Enterprises

A. *Three-Year Tax Exemption*

(4.68) Two rules in the act have a special significance for co-operatives. One provides that a co-operative shall be exempt from income tax for the first three years of its existence. It is proposed that this exemption be withdrawn. If the rules that govern the tax position of co-operatives in the fourth and subsequent years are fair, they should apply to the first three years as well.

B. *Interest on Capital Employed*

(4.69) The second rule provides that patronage dividends are deductible in computing the taxable income of the co-operative, subject to a limit. Patronage dividends are deductible before interest paid (other than interest to a bank or credit union) and cannot reduce profits at that point in the computation below 3 per cent of capital employed. This might be thought to ensure that members are taxed on some return on their investment in the co-operative. However, the 3 per cent is far too low in current circumstances. Further, because such other debts as mortgages are taken into account in determining the capital employed, the effective interest taxed to members can be even lower than 3 per cent. (A $200,000 mortgage at an interest rate of 7½ per cent would result in no taxable return on members' investment of $300,000.)

(4.70) The government proposes that the interest rate be set in accordance with a formula comparable to the formula used to determine the rate on farm improvement loans—that is, the rate would vary from year to year depending upon the interest rates paid on government bonds. It is also proposed that only interest paid to members on their loans and capital be taken into account after the deduction of patronage dividends.

C. *Credit Unions and Caisses Populaires*

(4.72) These organizations, which are co-operatives operating in the financial field, are specifically exempt from income tax under the present legislation. Originally caisses populaires and credit unions were small organizations serving limited groups of people basically on a non-profit basis. However, with the increased scope of their activities and operations, some of them are in real competition with other financial institutions.

(4.73) The government proposes to treat caisses populaires and credit unions as other co-operatives are treated. They would of course be granted deductions for doubtful debt reserves and market liquidity reserves comparable to those allowed to banking institutions.

Farmers and Fishermen

A. *Cash basis for Computing Income*

(5.48) Farmers are also at present entitled to compute their income on a cash basis. The government has given serious consideration to this provision and has concluded that it should remain. As regards market farmers, their inventories are so perishable that year-end inventories are not significant. Under present marketing arrangements, grain farmers are not permitted to sell their own inventories and it would be unfair to require them to pay tax on an amount that they could not take steps to realize. This leaves livestock farmers.

B. *Basic Herds*

(5.49) Livestock farmers have been able to treat part of their herds as a capital investment. The cost of acquiring or raising these animals is a non-deductible capital expenditure and the proceeds of their sale gives rise to a non-taxable capital gain. Under the government's proposals capital gains would in future be taxable so that this "basic herd" concept would be obsolete. It is not thought appropriate to add a change to accrual accounting on top of this "basic herd" change.

(5.50) The government does not propose to tax capital gains that accrue before the new system begins. Consequently the fair market value of a farmer's basic herd at the beginning of the new system would be tax-exempt. His basic herd would be treated as an inventory of animals that he purchased at their fair market value at the commencement of the system.

C. *Straight-Line Depreciation*

(5.51) Farmers and fishermen are now entitled to avoid the recapture of depreciation on the sale of their depreciable assets if they claim depreciation on what is called the straight-line system—computed at rates generally one-half of those used under the asset-class system. Any profit on the sale of such a depreciable asset is considered a capital gain.

Once capital gains are taxable, the advantages of the straight-line system disappear and farmers and fishermen would find it advantageous to use the asset-class system because

(1) of the more generous rates, and

(2) profits on the sale of assets reduce the base for subsequent depreciation rather than bearing tax immediately.

Naturally, the proceeds of the sale of assets owned on the day the system starts would continue to be tax-free to the extent that they represent a capital gain accrued to that date—that is, the fair market value exceeds the net book value of asset on commencement day and the taxpayer is able to realize that excess.

D. *Hobby Farms*

(5.52) Section 13 of the Income Tax Act limits the deductibility for tax purposes of losses suffered on the operation of what are commonly referred to as "hobby farms". A taxpayer who is not primarily a farmer can deduct only $5,000 of farming losses annually from his other income—all of the first $2,500 of losses and half of the next $5,000.

(5.53) Because this provision is intended to prohibit the deduction of personal expenses from taxable income, it would remain in the act under the new system. A taxpayer would, however, be allowed to reduce these non-deductible losses by capitalizing property taxes on the farm and interest paid on loans related to the purchase of the farm. By "capitalizing" we mean adding the amount involved to the cost to the taxpayer of the farm. This procedure would reduce the capital gain taxed on the sale of the farm, but it would not be allowed to increase the capital loss that may be deducted.

E. *Averaging of Income*

(2.57) It is not proposed to remove the present averaging formula for farmers or fishermen, who would be free to use either system. But a year included in a block of years averaged under the present system could not be used in applying the proposed new formula. Current provisions permitting averaging over a period for special lump-sum business receipts from recaptured capital cost allowance, inventory revaluation, the sale of inventory and the sale of receivables would be phased out. For corporations the phase-out would begin once the transition to one rate of corporate tax is complete. Lump-sum payments out of pension funds, or from employers on retirement, could be averaged on the new formula or, subject to certain safeguards, paid into a registered retirement savings plan, over and above the normal limit on such payments. A similar opportunity to pay extra amounts into registered retirement savings plans might be afforded to those having certain other types of irregular or short-term incomes such as authors and professional athletes. Withdrawals from such registered plans would be fully taxable and made on a regular and controlled basis.

Accrual Method of Computing Income for Professions

(5.46) Generally, taxpayers who are in business must compute their taxable income on what is known as the accrual basis. This means that a merchant must take into account the inventory of goods he has on hand, the amounts due to him from his customers, and the amounts he owes to his suppliers. An exception to this general rule has for many years been made for taxpayers in the professions (doctors, dentists, lawyers, chartered accountants, professional engineers, etc.). These taxpayers have been permitted to choose to report their income either on the accrual basis or on the cash basis—that is, they could omit the amounts due them from their clients and their "inventory" of unbilled time. Once a taxpayer chooses one basis he cannot switch to the other without the consent of the Minister. The government believes that the tax postponement permitted by this concession has given professionals an unwarranted advantage by comparison to the rest of Canadians, and it therefore proposes that professionals be required to use the accrual basis.

(5.47) A problem would exist in switching professional taxpayers now on the cash basis over to the new system. This problem relates to their receivables and inventories at the date of the change over. For example, if 1971 is the first year of the new system, the problem would relate to the receivables and inventories as at the end of 1970. These amounts would not have been included in the taxpayer's 1970 income because they would not have been collected at that time. They would not be included in the 1971 income because they were earned before that time. To require that the entire amount be brought into 1971 income would impose an abnormal tax liability in that year. As a consequence,

the government proposes that these taxpayers be entitled to bring these amounts into income over a number of years. Specifically, they would bring them into income as their total outstanding receivables and inventories are reduced. This amount would of course be in addition to the amount of their income computed on the accrual basis and would mean that they would be taxed on the greater of a cash-basis income or an accrual-basis income until they catch up to other Canadian businessmen.

Prospectors

(5.45) For many years the act has continued a provision which specifically exempts from tax the proceeds received by a prospector or a grubstaker on the sale of a mining property. This provision was intended to make it clear that the government viewed this type of gain as a capital gain which under the existing system would of course be tax-exempt. Under the new proposals capital gains are to be taxed and this exemption would therefore be repealed.

Consolidated Tax Returns

(5.22) The government considers that its proposal whereby a corporation can be treated as a partnership would permit groups of corporations to achieve the same result as they would under consolidated returns. Therefore, the government does not propose to provide for consolidated returns as such.

Transfer to Provinces of Taxes Paid by Electric, Gas or Steam Utilities

(4.63) In 1966, Parliament passed the public Utilities Income Tax Transfer Act under which the Minister of Finance turns over to the provincial governments 95 per cent of the corporation tax collected from certain electric, steam and gas utility corporations.

Trusts

A. Trusts which issues Transferable or Redeemable Units

(5.56) Because a trust is not taxed on income which is payable to its beneficiaries during the year, many trusts do not pay any tax at all. Some of these trusts are in direct competition with widely-held public corporations and have as many beneficiaries (in this case usually unit holders) as some public corporations have shareholders. The tax rules give these trusts an advantage over their competitors. It is proposed that a trust be treated as a corporation if it has issued transferable or redeemable units, each of which represents a specific undivided interest in the trust property. If the number of unit holders and marketability of the units warrant it, the trust would be treated as a widely-held corporation. If such a trust were a mutual fund, it would be taxed in the same manner as an incorporated mutual fund.

B. Income Accumulating in hands of Trustee

(5.57) The fact that a trust is entitled to use the personal rate scheduled in computing its tax means that income accumulated in a trust may bear significantly less tax than if the income were taxable to the beneficiaires, and the tax saving is not offset by a further tax when the funds are eventually distributed. (The number of accumulating trusts has increased significantly during the past few years.) If a trust is covered by the proposal set out in the preceding paragraph, this loophole would no longer be available. To close it for other trusts, it is proposed that income accumulating in such trusts be subject to a flat-rate federal tax of 40 per cent; provincial taxes would increase this rate to the neighborhood of 50 per cent and the corporate rate. A special relieving provision would reduce the rate in the case of trusts or estates arising on the death of someone whose economic circumstances were such that a 50-per-cent rate is not appropriate, provided no additional property is transferred to the trust by anyone else.

(5.58) Less is known of the use to which trusts are put in Canada than is the case with respect to corporations, and given the varied uses that are possible, it is difficult to foretell all of the effects of the proposal discussed in the preceding paragraph. Consequently the government issues a particular invitation to taxpayers who believe that they would be unfairly treated under it to make the facts of their case known to the Department of Finance so that modifications can be considered.

Non-Resident Owned Investment Corporations

(6.40) The proposed increase in withholding tax rates has implications for that category of corporation known as a "non-resident-owned investment corporation"; an entity taxed at 15 per cent on investment income but exempt from the obligation to withhold tax from dis-

tributions abroad. Such companies, while resident in Canada, are generally treated for tax purposes as non-resident persons. They constitute a convenient holding device for foreign investors in Canadian securities. The tax on such companies would be increased to match the rate of the non-resident withholding tax.

11. TAX TREATIES

(1.45) The Income Tax Act sets out the basic international elements of Canada's income tax. Modifications are made by negotiated tax treaties with other countries. The present reform proposals will involve renegotiation of such treaties as well as revision of the act.

(1.46) Relatively little change is proposed in the structure of taxes imposed on the Canadian income of people or corporations in other countries. However, to meet the problem presented by the diversion of income to "tax-haven" countries, the basic rate of withholding taxes set by the Income Tax Act on interest, dividends, rentals, and royalties paid or credited to non-residents would be increased to 25 per cent from 15 per cent. This increase would not override the rates in our existing treaties. Further, the 25-per-cent rate would generally be reduced in new treaties to the current levels, usually 15 per cent. Some new safeguards would be introduced to ensure that corporate income in Canada is not reduced artificially by making payments in the form of interest and royalties to non-resident shareholders or related companies, instead of paying dividends. Pensions paid from Canada to persons living outside would be subject to a withholding tax of 25 per cent, but with provision for lower or higher rates if the circumstances of the recipient warrant. This is proposed because it is planned to maintain tax exemptions for contributions to registered pension plans and the investment income of such plans in the expectation that payments out of the pension funds will be taxable income.

(2.26) Under our tax treaties with Britain, the United States and a number of other countries, professors and teachers who have come to Canada temporarily are exempt from Canadian income tax on their teaching salaries for two years. In some circumstances they are not taxed by the country where they are normally resident. Given the present scale of salaries of professors and teachers this arrangement is unjustified. We intend to remove this exemption, on a reciprocal basis, from our treaties and to tax such persons like others.

(6.26) In its tax treaties, Canada will also be prepared to recognize the income taxes levied by political subdivisions of foreign countries on a reciprocal basis. If the foreign country is prepared to give a foreign tax credit for the income taxes levied by the provinces, Canada will agree to give a credit or a deduction, whichever is appropriate, for the taxes levied by its political subdivisions.

(6.36) Statutory withholding rates usually fall within a range of 25 to 30 per cent, although they exceed 40 per cent in the United Kingdom and some other countries. The government proposes to increase the Canadian rate to 25 per cent. This increase would, of course, not override the limitations on withholding tax rates contained in Canada's existing tax treaties. Further, Canada would generally be prepared to reduce the rate to 15 per cent in new tax treaties with other countries.

(6.37) The increase in the rate of withholding tax would not apply to dividends before January 1, 1974. The delay in implementing the increase on dividends is in recognition of several factors: first, foreign shareholders have always been able to withdraw accumulated profits at 15 per cent and should not be penalized for having reinvested their earnings in Canada; second, Canada would be prepared to conclude tax treaties with most other countries providing for a 15-per-cent rate on dividends and third, most of Canada's existing treaties contain a 15-per-cent limitation.

(6.43) The general proposal to include capital gains in taxable income would require changes to the international provisions, including the extension of Canadian tax to gains by non-residents on the disposal of real property, partnership interests and branch assets in Canada.

(6.50) Taken together, the proposed changes in the taxation of international income add up to a significant change in tax policy. Canada would, in time, emerge with two international tax systems—a treaty system which would apply to income flowing to and from treaty countries, and a statutory system which would apply in non-treaty circumstances. By far the greatest portion of international income is expected to fall within the treaty system.

(6.51) It is not, of course, possible to forecast the exact form that Canada's tax treaties would take. They would undoubtedly vary from one country to another, depending on the results of separate negotiations. Nevertheless, over recent years a fairly standard international tax treaty pattern has emerged. This pattern has to a considerable extent been codified in a draft model tax convention published in 1963 by the Fiscal Committee of the Organization for Economic Co-operation and Development. While few countries are prepared to accept all provisions of this draft treaty, it does generally represent the norm among the major developed countries. Canada's tax treaties will undoubtedly be influenced to a considerable extent by this draft treaty, but we too will require some modifications.

12. BRANCH PROFITS TAX

(6.48) A foreign corporation which carries on business in Canada through a branch is liable for a special 15-per-cent tax on net after-tax profits it has available for withdrawal from Canada. This tax is counterpart to the 15-per-cent withholding tax applied to dividends paid by Canadian corporations to foreign shareholders. The rate would be increased in parallel with the change in the withholding rate on dividends.

(6.49) The formula for measuring the profits available for withdrawal contains a deduction for profits invested in land and depreciable assets. This deduction would be placed on a basis that took into account the depreciation of those assets, and a deduction would be added to recognize the need for working capital.

13. CANADIAN WITHHOLDING TAXES APPLICABLE TO NON-RESIDENTS

(1.46) Relatively little change is proposed in the structure of taxes imposed on the Canadian income of people or corporations in other countries. However, to meet the problem presented by the diversion of income to "tax-haven" countries, the basic rate of withholding taxes set by the Income Tax Act on interest, dividends, rentals, and royalties paid or credited to non-residents would be increased to 25 per cent from 15 per cent. This increase would not override the rates in our existing treaties. Further, the 25-per-cent rate would generally be reduced in new treaties to the current levels, usually 15 per cent. Some new safeguards would be introduced to ensure that corporate income in Canada is not reduced artificially by making payments in the form of interest and royalties to non-resident shareholders or related companies, instead of paying dividends. Pensions paid from Canada to persons living outside would be subject to a withholding tax of 25 per cent, but with provision for lower or higher rates if the circumstances of the recipient warrant. This is proposed because it is planned to maintain tax exemptions for contributions to registered pension plans and the investment income of such plans in the expectation that payments out of the pension funds will be taxable income.

(6.35) The high rates in other countries effectively curtail some of the more obvious opportunities for international tax avoidance. The modest rates in Canada have enabled taxpayers to make use of "incorporated pocketbooks", trusts and other devices in tax-haven jurisdictions to artificially reduce the tax load on Canadian-source interest, dividends and royalty payments. The proposal discussed above concerning "passive income" would partially frustrate this opportunity for abuse, but would not eliminate it. A general increase in the rate of the non-resident withholding tax is also necessary.

(6.36) Statutory withholding rates usually fall within a range of 25 to 30 per cent, although they exceed 40 per cent in the United Kingdom and some other countries. The government proposes to increase the Canadian rate to 25 per cent. This increase would, of course, not override the limitations on withholding tax rates contained in Canada's existing tax treaties. Further, Canada would generally be prepared to reduce the rate to 15 per cent in new tax treaties with other countries.

(6.37) The increase in the rate of withholding tax would not apply to dividends before January 1, 1974. The delay in implementing the increase on dividends is in recognition of several factors: first, foreign shareholders have always been able to withdraw accumulated profits at 15 per cent and should not be penalized for having reinvested their earnings in Canada; second, Canada would be prepared to conclude tax treaties with most other countries providing for a 15-per-cent rate on dividends and third, most of Canada's existing treaties contain a 15-per-cent limitation.

(6.38) The increase would apply to the other categories of income now subject to the non-resident withholding tax from January 1, 1971, with the following exceptions:

(1) As mentioned the increased rates would not override the limitations contained in Canada's existing tax treaties.

(2) The increase in rates would be postponed to January 1, 1974 on interest, rents and royalty payments where the obligation arises out of an agreement in writing concluded before the date on which this White Paper is published.

(3) The rate of withholding tax would remain at 15 per cent on interest payable on bonds or other obligations held by persons dealing at arm's length with the issuer, if the obligation is issued before 1974 and is held by a person resident in a country where Canada's present tax treaty limits the withholding tax to 15 per cent.

(6.39) Several special categories of interest (including interest on federal, provincial and municipal debt obligations) are exempt from withholding taxes. These would continue to be exempted. However, interest on obligations issued after January 1, 1974 would only be exempt if the recipient is a resident of a country with which Canada has a tax treaty.

14. 15 PER CENT TAX ON UNDISTRIBUTED INCOME ON HAND AT END OF 1970 FISCAL YEAR

(4.78) Two provisions are proposed to ensure that the taxes which would become due under the existing tax system are not forgiven. As the earnings accumulated before the new system begins—"undistributed income on hand" to use the technical phrase—are distributed, a special 15-per-cent tax would be levied. The distribution would then be considered as a return of capital to the shareholders, offsetting part of the cost or beginning value of their shares. This procedure would continue, and extend somewhat, the existing provision concerning distributions of undistributed income on payment of a flat-rate 15-per-cent tax. Corporations could elect to treat early distributions as being of this nature and so clear up their situation.

APPENDIX "B"

PROPOSALS FOR TAX REFORM
SPECIAL STUDY NO. 1
SUMMARY OF PROPOSALS THAT WOULD NOT BE EFFECTIVE IMMEDIATELY

Proposals	*Transitional Provisions*
(A) Taxation of Capital Gains	
3.13 The government proposes that capital gains be subjected to a progressive tax as part of the general income tax system. Depending on the nature of the asset, all or part of the gain would be included in income and taxed at the taxpayers' marginal rate. Similarly, all or part of capital losses suffered by a taxpayer would be deductible from taxable income and so save the taxpayer tax at his marginal rate. It would be necessary to prohibit the deduction of losses which are in fact the result of personal consumption: for example, the loss on a sale of the family car.	3.15 The government does not propose to tax gains that arise before the new system is introduced unless those gains would have been taxed under the present system. Consequently, the general rule woud be that taxpayers could deduct from the proceeds of sale of assets the value of those assets on "valuation day". Consider the case of the taxpayer who bought a block of shares in 1964 for $1,500 which today is worth $2,500. If the new system were to go into effect with today as valuation day, and if the taxpayer were to sell his shares a year from now for $2,600, his taxable gain would be only $100. If he were to sell them for $2,100, he would have a loss for tax purposes of $400.
	3.16 The natural and ordinary thing to do would be to proclaim that valuation day is to be the day on which the new system is to begin. However, if that were done, the pressure on market prices on that day could be tremendous, and the opportunities for price-fixing too great. To avoid these consequences, the goverment proposes to choose a day close to the beginning of the system and to announce that evening that it was valuation day.
3.36 The proposal that the accrued gains or losses on those shares be taken into account every five years is one of the two exceptions of the general rule that capital gains and losses would be taxable only when they are realized. (The other exception concerns taxpayers who leave Canada.) Periodic revaluation would reduce somewhat the value of the half-gains rule. It would reflect the fact that	3.8 The process would not begin until five years after capital gains become taxable. Beginning in the fifth year, individual taxpayers would revalue their holdings of shares of widely-held Canadian corporations in each year in which they attain an age that is divisible by five. Corporations would also revalue their holdings of these shares every five year, likely on the fifth anniversary of incorpora-

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these shares are readily marketable and that a taxpayer can, therefore, realize his gain or loss fairly easily at the time of his choosing. The shares of private companies do not have the same marketability.

3.37 Periodic revaluation would also reduce the "lock-in" effect that might well otherwise occur. If a taxapayer faces a tax on the sale of an investment, and that tax is postponed if he holds on to the investment, he may feel "locked in". As long as he holds, he would have, say, $100 working for him. If he sells, he would have only, say, $90 or $95 to reinvest. Since periodic revaluation would reduce this lock-in effect, it would reduce what might otherwise be an obstacle to the workings of the capital market. Revaluation would also make it feasible for the government to classify more corporate reorganizations and mergers as tax-free transactions than would otherwise be the case, thus removing a tax barrier that might otherwise have impeded transactions that are desirable for economic reasons. Finally, it would reduce the tax postponement which would otherwise result from the treatment suggested in paragraph 3.42 to those cases where the lack of marketability of the assets made the treatment compelling.

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tion and each other anniversary divisible by five. Dispersing the valuation process through a five-year cycle would reduce the pressure in any particular year—the pressure of the work load on the administration and the pressure that might otherwise develop on market prices every five years. To further disperse this latter pressure, it is proposed that revaluation take place as of the end of the month in which the significant birthday or anniversary takes place.

(B) Tax on First $35,000 of Taxable Income

4.30 It is therefore proposed that the low rate be removed from the business profits of small corporations gradually over a period of five years. For corporations with taxable business profits not greater than $35,000 the low rate would apply to $28,000 in the first year of transition, $21,000 in the second, $14,000 in the third, $7,000 in the fourth, and be eliminated entirely in the fifth year. For corporations with taxable business profits above $35,000, the amount subject to the low rate would be reduced more quickly the more the corporation's taxable profits exceed $35,000. The benefit would be removed immediately if taxable business profits equal or exceed $105,000. In other words, the larger the corporation the more quickly it would

4.31 The precise formula would remove 80 cents of a corporation's entitlement to be taxed at the low rate for each $2 of business income in excess of $35,000 in the first year of transition. In the second year the reduction would be 60 cents for each $2; in the third year, 40 cents for each $2; and in the fourth year, 20 cents for each $2. In the meantime the maximum entitlement would be reduced, so that the effect would be a gradual reduction in the amounts subject to the low rate of tax. For example, a company with taxable business profits of $85,000 in each of the first five years of the new system would be entitled to have $8,000 taxed at the low rate in the first year, $6,000 in the second year, $4,000 in the third year, $2,000 in the fourth

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lose the benefit designed for small corporations.

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year and nothing the fifth year. On the other hand, a corporation that earns $45,000 in each of the first five years would be entitled to have $24,000, $18,000, $12,000, $6,000 and zero taxed at the low rates.

(C) Foreign Corporations Operating In Canada

Foreign Corporations Operating in Canada

4.66 The present dividend tax credit applies to dividends received from taxable Canadian corporations. This phrase can cover all corporations resident in Canada whether or not they are incorporated under Canadian laws. As part of its program to improve the effectiveness of the tax system, the government proposes to remove some of the distinctions now made between corporations on the basis of residence and to distinguish instead on the basis of the place of incorporation. (It is posible for foreign corporations to move out of Canadian jurisdiction entirely. This type of manoeuvre is not open to corporations created under Canadian law.) Under the new proposals, the system of credits for corporate tax would apply only to coporations incorporated in Canada.

4.67 This provision could mean a substantial change to some foreign corporations which now are resident in Canada and whose dividends now qualify for the dividend tax credit. Consequently it is proposed that dividends from these corporations be treated the same as dividends from Canadian corporations for a temporary period of five years in order to give them time to rearrange their affairs to conform with the new tax laws.

(D) Goodwill and Other Intangibles

5.4. There is a class of expenditure incurred by businesses that is not deductible, either in the year in which the expenditure is incurred or over a series of years. The taxpayer is prohibited from deducting them in the year in which they are incurred because they are capital expenditures. He is prohibited from deducting the cost over a number of years by way of depreciation because they do not give rise to an asset for which provision is made in the depreciation regulations. Perhaps the best known of these capital nothings is goodwill. If a Canadian buys a business, he can neither deduct nor depreciate the portion of his purchase price that relates to the goodwill of the business.

5.7 The goodwill of a business has been described as the value that can be placed on the fact that customers are more likely to trade with that firm than with a new firm in the same line. This likelihood arises in part as a result of advertising and in part because customers have been satisfied in their past dealings with the firm. Clearly, goodwill is a thing that must be kept up. If a firm stops advertising or if it stops giving satisfactory service, its goodwill will disappear. Therefore, the goodwill that a firm has now is the result of its past actions, and the goodwill that it has five years from now will be the result in part of its past actions and in part of its actions in the next five years. The government proposes to recognize this fact in the treatment of taxpayers who sell goodwill in the future. The longer the period after the beginning of the new system before the sale takes place, the more of the proceeds of sale that would be taxable and the smaller the part of the proceeds that would be exempt.

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5.5 The government proposes to create a new depreciation class which would sweep up all of these nothings and which would enable the taxpayer to deduct 10 per cent of the book value of this class each year. We believe that the 10-per-cent rate is fair if one takes into account the type of expenditure to be included.

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5.8 Another fact must be taken into account in setting the treatment of early sales of goodwill; purchasers would be willing to pay more for goodwill under the proposed system (since they can deduct the expenditure for tax purposes over a period of years) than they are willing to pay under the existing system. With these factors in mind, the government proposes that taxpayers who sell goodwill in the first year of the new system would be taxable on 40 per cent of the proceeds and exempt on 60 per cent; if in the second year, taxable on 45 per cent and exempt on 55 per cent; and so on, with the taxable portion increasing by 5 percentage points each year until the thirteenth year when 100 per cent of any proceeds would be taxable. Naturally, if a sale of goodwill involves a business that was not in existence when the new system commences, all of the proceeds would be taxable even though the sale takes place before 12 years have passed.

(E) Maximum Rate of Tax on Individuals of about 50 per cent

2.42 The government has concluded that as the taxation of capital gains becomes fully effective, and transitional measures in the new system have ceased to be important, top rates of combined federal and provincial personal income tax should be reduced to 50 per cent. The top rates should gradually be reduced from the present levels, in four instalments commencing in the second year in which the new system applies.

2.43 After this change becomes fully effective the rates of tax on those who now report taxable income in excess of $40,000 would be lower than at present but as result of proposed changes in the taxation of corporations and corporate distributions, restrictions on expense deductions and the inclusion of gains, the amount they have to report as income for tax purposes would be susbtantially increased. The taxes on capital gains would be paid mainly by those in the higher brackets and after the first few years should produce hundreds of millions of dollars. This increase in the tax base is a far better way of taxing the wealthy than having ostentatiously high rates on an incomplete tax base.

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(F) Mining Companies

(a) Proceeds of sale of mineral rights

5.28 Also since 1962, the proceeds of sale of oil rights and natural gas rights have been treated as taxable income. As part of the proposal to tax capital gains, this rule would also be extended to apply to all mineral rights. A special rule would be applied to the proceeds of the sale of rights which are held on the day this White Paper is published if the proceeds of the sale of those rights would not have been income for tax purposes under the existing rules. This special, transitional rule is similar to that proposed in paragraph 5.8 with respect to existing goodwill; if the sale is in the first year of the new system, only 60 per cent of the proceeds would be taken into account; if in the second year, 65 per cent; the third year 70 per cent; and so on, increasing by 5 per cent each year until all of the proceeds are taken into income if the sale is in the ninth or a subsequent year. Since the cost of these rights would henceforth be deductible for tax purposes, prices should rise and this system should produce a fair after-tax return to the present owners.

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(b) Three year tax holiday

5.35 The present three-year exemption would continue to apply until December 31, 1973, in accordance with the announcement made by the then Minister of Finance in May, 1967. New mines which have come into production in commercial quantities before the publication of this White Paper would be eligible for the exemption but would not be able to take advantage of the new proposal concerning fast write-off. New mines which come into production after the publication of this White Paper but before January 1, 1974 would be entitled to elect to take advantage of either incentive but not both. Specifically, they would be entitled to claim exemption of the profits earned either in the first three years of operation or in the period remaining to January 1, 1974, if that is shorter. At the end of the exempt period they would be entitled to the fast write-off of the capital cost of their mine assets, but only if they reduce the book value of those assets by the full amount of their exempt profits.

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(c) Depletion

5.40 The government believes that both of these inefficiencies can be substantially reduced if depletion allowances are more directly related to the activities which it is desired to affect. Consequently it is proposed that, after a suitable transitional period in respect of mineral rights held by the taxpayer on the day this White Paper is published, depletion allowances would have to be "earned". The existing maximums would continue to apply—that is, generally no more than ⅓ of production profits—but a taxpayer could only deduct these maximums, or any amount, if he spends enough on exploration for or development of mineral deposits in Canada or on those fixed assets described in paragraph 5.29 that are acquired for the exploitation of a new Canadian mine. The formula proposed is that for every $3 of eligible expenditures made after this White Paper is published a taxpayer would earn the right to $1 of depletion allowance. If his profits that year are not sufficient to permit him to deduct the amount earned, he could carry the undeducted amount over to subsequent years. The cost of acquiring mineral rights would not be an eligible expenditure for this purpose.

5.42 The system would not become fully effective immediately. The government proposes that for the first five years of the new system taxpayers be entitled to depletion allowances in respect of production profits from properties they now own without having to "earn" them. This period, combined with the entitlements to the earned allowances that taxpayers would be able to accumulate between the publication of this White Paper and the end of 1975, should enabe the mineral industries to make a smooth transition to the new system.

(G) The Professions and Cash Basis of Computing Income

5.46 Generally, taxpayers who are in business must compute their taxable income on what is known as the accrual basis. This means that a merchant must take into account the inventory of goods he has on hand, the amounts due to him from his customers, and the amounts he owes to his suppliers. An exception to this general rule has for many years been made for taxpayers in the professions (doctors, dentists, lawyers, chartered accountants, professional engineers, etc.). These taxpayers have been permitted to choose to report their income either on the accrual basis or on the cash basis—that is, they could omit the amounts due them from their clients and their "inventory" of unbilled time. Once a taxpayer chooses one basis he cannot switch to the other without the consent of the Minister. The government believes that the tax postponement permitted by this concession has given professionals an unwarranted advantage by comparison to the rest of Canadians, and it therefore proposes that

5.47 A problem would exist in switching professional taxpayers now on the cash basis over to the new system. This problem relates to their receivables and inventories at the date of the change over. For example, if 1971 is the first year of the new system, the problem would relate to the receivables and inventories as at the end of 1970. These amounts would not have been included in the taxpayer's 1970 income because they would not have been collected at that time. They would not be included in the 1971 income because they were earned before that time. To require that the entire amount be brought into 1971 income would impose an abnormal tax liability in that year. As a consequence, the government proposes that these taxpayers be entitled to bring these amounts into income over a number of years. Specifically, they would bring them into income as their total outstanding receivables and inventories are reduced. This amount would of course be in addition to the amount of their income com-

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professionals be required to use the accrual basis.

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puted on the accrual basis and would mean that they would be taxed on the greater of a cash-basis income or an accrual-basis income until they catch up to other Canadian businessmen.

(H) Dividends from Foreign Sources

6.15 The government has concluded that neither of these systems is either "right" or "wrong". It proposes to continue in a restricted form the present exemption of dividends received by a Canadian corporation from a controlled foreign corporation. For this purpose, the Canadian corporation would be assumed to control the foreign corporation if it owns 25 per cent or more of the voting shares of the foreign corporation. The first restriction proposed is that the exemption privilege would be extended only to dividends from those countries with which we have concluded bilateral tax treaties. A second is that the effect of the exemption would be eliminated for certain types of diverted income by the proposals described below under the heading "Passive Income of Controlled Foreign Corporations." These restrictions are necessary to frustrate efforts to use the dividend exemption to reduce artificially the tax burden on tax-haven income.

6.16 Where it applies, the exemption system would permit Canadian corporations to compete abroad without being at a fiscal disadvantage vis-a-vis their competitors, including the competing subsidiaries of European corporations. It is obviously an easier system to comply with than the foreign tax-credit system, although corporations would have to be able to show that their controlled foreign corporations do not run afoul of the passive income provisions. If it is slightly generous in some circumstances, it should not divert Canadian investment abroad to do that it must compete with the system of credit for Canadian corporate tax. And of course Canadian personal tax would still be due when the profits are distributed to Canadian shareholders.

6.17 A dividend from a Canadian-controlled foreign corporation not protected by tax treaty would be subject to a tax-credit regime. The Canadian corporation would be allowed a credit for the foreign withholding taxes imposed on the dividend and for any foreign corporate tax imposed on the underly-

6.18 The existing dividend exemption system would be retained for several years, at least through 1973, as a transitional measure until an appropriate network of international tax treaties can be built up.

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ing business profits from which the dividend was paid. This would reduce or eliminate taxes due on the dividend, which taxes would be computed on the dividend plus the tax for which credit was available.

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(I) Foreign Investment Income

6.22 At present, a Canadian individual who receives foreign investment income, and a Canadian corporation that receives foreign investment income other than a dividend from a controlled foreign corporation, include the investment income in taxable income and can deduct from the Canadian tax on that income the foreign income taxes he has paid to the government of the foreign country. The government proposes to continue this treatment substantially unchanged. However it believes that in normal circumstances the rate of withholding tax levied on portfolio investment income flowing between countries that have a tax treaty should not exceed 15 per cent. For its part, Canada will be willing to limit its withholding tax on such income to 15 per cent. To achieve balance, it is proposed that the maximum rate of tax for which foreign tax credit would be granted on this type of income be 15 per cent. To provide time for Canada to expand its tax-treaty network, and for taxpayers to rearrange their investments, this rule would not go into effect until 1974.

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(J) Foreign Business Corporations

6.31 "Foreign business corporation" is a technical expression for a type of corporation that is exempt from Canadian income tax. To qualify, a corporation must carry on all of its business operations, except management and a few other specified activities, outside Canada. Originally, this category was provided to make sure that several large Canadian public corporations with business operations entirely outside Canada did not suffer "double taxation" on their business profits. It did for these corporations what the exemption system did for corporations that operated abroad through controlled foreign corporations.

6.33 It is repugnant in principle to have a special status for some corporations when others which are identical in every other respect cannot qualify: Moreover, the status granted is inconsistent with the provisions proposed concerning passive foreign income of controlled foreign corporations. (Foreign business corporations could receive investment income tax-free, but controlled foreign corporations would not be permitted to do so.) The government therefore proposes to withdraw the exemption. It would be withdrawn immediately with respect to "passive income", but would be transferred to a foreign tax-credit system over a period of five years for business profits. This would give existing corporations an opportunity to rearrange their affairs. Many would likely be able to avoid double tax by qualifying their foreign operations in controlled foreign corporations.

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6.32 However, during the 1950s other corporations appeared that passed the test for Canadian exemption but were not taxable in any other country either, often because of Canada's tax treaties with the countries with which they traded. Canada had become a tax haven. In 1959 Parliament provided that no new foreign business corporations could be created.

6.33 It is repugnant in principle to have a special status for some corporations when others which are identical in every other respect cannot qualify. Moreover, the status granted is inconsistent with the provisions proposed concerning passive foreign income of controlled foreign corporations. (Foreign business corporations could receive investment income tax-free, but controlled foreign corporations would not be permitted to do so.) The government therefore proposes to withdraw the exemption. It would be withdrawn immediately with respect to "passive income", but would be transferred to a foreign tax-credit system over a period of five years for business profits. This would give existing corporations an opportunity to rearrange their affairs. Many would likely be able to avoid double tax by qualifying their foreign operations in controlled foreign corporations.

(K) Withholding Taxes

6.36 Statutory withholding rates usually fall within a range of 25 to 30 per cent, although they exceed 40 per cent in the United Kingdom and some other countries. The government proposes to increase the Canadian rate to 25 per cent. This increase would, of course, not override the limitations on withholding tax rates contained in Canada's existing tax treaties. Further, Canada would generally be prepared to reduce the rate to 15 per cent in new tax treaties with other countries.

6.37 The increase in the rate of withholding tax would not apply to dividends before January 1, 1974. The delay in implementing the increase on dividends is in recognition of several factors: first, foreign shareholders have always been able to withdraw accumulated profits at 15 per cent and should not be penalized for having reinvested their earnings in Canada; second, Canada would be prepared to conclude tax treaties with most other countries providing for a 15-per-cent rate on dividends and third, most of Canada's existing treaties contain a 15-per-cent limitation.

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(L) Non-Resident Owned Investment Corporations

6.40 The proposed increase in withholding tax rates has implications for that category of corporation known as a "non-resident-owned investment corporation"; an entity taxed at 15 per cent on investment income but exempt from the obligation to withhold tax from distributions abroad. Such companies, while resident in Canada, are generally treated for tax purposes as non-resident persons. They constitute a convenient holding device for foreign investors in Canadian securities. The tax on such companies would be increased to match the rate of the non-resident withholding tax.

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(N) Averaging of Income in Respect of:

(a) Recaptured capital cost allowances;
(b) Investories;
(c) Sales of Investories;
(d) Sales of receivables.

2.57 It is not proposed to remove the present averaging formula for farmers or fishermen, who would be free to use either system. But a year included in a block of years averaged under the present system could not be used in applying the proposed new formula. Current provisions permitting averaging over a period for special lump-sum business receipts from recaptured capital cost allowance, inventory revaluation, the sale of inventory and the sale of receivables would be phased out. For corporations the phase-out would begin once the transition to one rate of corporate tax is complete. Lump-sum payments out of pension funds, or from employers on retirement, could be averaged on the new formula or, subject to certain safeguards, paid into a registered retirement savings plan, over and above the normal limit on such payments. A similar opportunity to pay extra amounts into registered retirement savings plans might be afforded to those having certain other types of irregular or short-term incomes such as authors and professional athletes. Withdrawals from such registered plans would be fully taxable and made on a regular and controlled basis.

2.57 It is not proposed to remove the present averaging formula for farmers or fishermen, who would be free to use either system. But a year included in a block of years averaged under the present system could not be used in applying the proposed new formula. Current provisions permitting averaging over a period for special lump-sum business receipts from recaptured capital cost allowance, inventory revaluation, the sale of inventory and the sale of receivables would be phased out. For corporations the phase-out would begin once the transition to one rate of corporate tax is complete. Lump-sum payments out of pension funds, or from employers on retirement, could be averaged on the new formula or, subject to certain safeguards, paid into a registered retirement savings plan, over and above the normal limit on such payments. A similar opportunity to pay extra amounts into registered retirement savings plans might be afforded to those having certain other types of irregular or short-term incomes such as authors and professional athletes. Withdrawals from such registered plans would be fully taxable and made on a regular and controlled basis.

(O) Averaging of Income of Individuals

2.53 Income tax is levied on a year's income at a time, at a rate that normally depends on the size of that year's income alone. But some types of income are irregular, and tax must be paid at a higher rate in a year when income is abnormally high. This may cause taxpayers with irregular or varying incomes to pay significantly higher taxes over a series of years than those whose incomes are more regular. Special provisions in the existing law permit farmers and fishermen to average their incomes over a block of five years, authors over three years, and businessmen on certain unusual types of income over three or five years. Certain types of single payments out of pension funds, or by employers on retirement of an employee, can be taxed at the average rate of tax paid by the employee over the preceding three years.

2.58 It would not be possible to bring the general averaging arrangement into effect immediately. It would be necessary to have the records of assessed income for previous years for all or nearly all taxpayers before the system could be fairly used. Until this accumulation of information reaches five years it would be necessary to use a shorter series of years, with a lower "threshold level".

APPENDIX "C"

PROPOSALS FOR TAX REFORM SPECIAL STUDY NO. 2

REFERENCES TO LOOPHOLES AND TAX AVOIDANCE

PROPOSALS FOR TAX REFORM REFERENCES TO LOOPHOLES AND TAX AVOIDANCE

(A) Capital Gains Taxation

2.38 Bringing capital gains into income alters our approach to rates of income tax in excess of 50 per cent. Taxing capital gains would increase taxes substantially on the well-to-do. It would do this both directly and by making it possible to plug effectively more of the loopholes which can be used to obtain financial benefits in ways not subject to income tax. It is therefore possible and proper to consider what maximum rate of income tax on individuals is desirable in economic terms.

A higher rate, when applied to a comprehensive definition of income including capital gains, would deter savings and the investment of savings, particularly in venturesome enterprises. Moreover, there is a danger that rates higher than 50 per cent applied to the earned income of proportional workers and executives would lead to some slackening in their efforts and a desire to take benefits in the form of holidays, retirement pay, and other nonproductive and less-taxable forms. Canada needs the full effort of those with outstanding ability. It must compete for such people with other countries where able Canadians can go to live and to work if they wish.

2.39 The royal commission recommended that when capital gains were made taxable and the various loopholes blocked, the maximum rate of tax on income should be 50 per cent. The government does not accept all the theoretical arguments of the commission in favor of this rate. It is impressed, however, with economic arguments for this course.

4.42 As mentioned above and in Chapter 3, the government proposes that half of the gain on the disposal of a share of a Canadian public corporation be taken into account in computing taxable income. This lower rate of tax on the gain would complement the partial credit given for corporate tax and provide the other half of the government's incentive to Canadians to invest in Canadian corporations. To forestall a fairly straightforward tax-avoidance technique, it would be necessary to grant deduction for only half of the loss on the sale of such a share.

(B) Shares of Closely-held Canadian Corporations

3.31 The definition of a closely-held Canadian corporation is given in Chapter 4, but it would include most Canadian private corporations. Gains on the sale of shares of these corporations would be fully taxed, and losses on the sale of such shares would be fully deductible (subject to protection against the deduction of personal expenses). This treatment, when coupled with the credit given to Canadian shareholders for the Canadian corporate tax paid by these companies, (see Chapter 4) would produce a balanced system in which there is little if any tax advantage to be secured by a taxpayer through receiving his share of the income of the corporation in the form of gains on the sale of shares rather than dividends, or vice versa. This would remove one of the strongest temptations to tax avoidance in the present act. It would also produce a system in which the weight of tax on private companies is identical to that on the unincorporated businesses with which they compete. This balance is explained more fully in Chapter 4.

(2) Intercorporated Holdings

4.53 However, the exemption does give rise to two problems under the existing law. The first is that it would, in the absence of special provisions have permitted Canadians to transfer their shares in public Canadian corporations to a corporation which they control. In this way, they could have postponed until the time of their choice all personal taxes normally due when the dividend from the public corporation came under their control. An attempt has been made to close this loophole by defining a type of corporation—referred to as a personal corporation—the income of which is taxed against the shareholders whether or not it is distributed. However, in practice the definition has been unsatisfac-

tory. It has also been difficult to define satisfactory rules for allocating income to the shareholders in situations where the corporation has a complicated share structure.

(D) Foreign Corporations Operating in Canada

4.66 The present dividend tax credit applies to dividends received from taxable Canadian corporations. This phrase can cover all corporations resident in Canada whether or not they are incorporated under Canadian laws. As part of its program to improve the effectiveness of the tax system, the government proposes to remove some of the distinctions now made between corporations on the basis of residence and to distinguish instead on the basis of the place of incorporation. (It is possible for foreign corporations to move out of Canadian jurisdiction entirely. This type of manœuvre is not open to corporations created under Canadian law.) Under the new proposals, the system of credits for corporate tax would apply only to corporations incorporated in Canada.

(E) Capital Cost Allowances and Buildings

5.15 In the meantime some changes are desirable. Because the depreciation rates apply to net book value, maximum depreciation reduces year by year. Consequently the rates must be higher than under a straight-line system in which the same amount of depreciation is taken each year. This results in higher-than-average deductions in the early years that an asset is owned, and lower-than-average deductions in later years. The longer the useful life of the asset, (and, therefore, the lower the depreciation rate prescribed) the longer it is before the cross-over point is reached. The longest period of higher deductions probably relates to buildings.

5.16 Many taxpayers who would otherwise be in quite high tax brackets have become landlords, and have been able to reduce or eliminate the tax on their other income by claiming the maximum depreciation on their buildings. Ideally this early generosity should be offset by lower depreciation deductions in later years, or by recapture of the extra depreciation on sale. However, if the taxpayer buys additional buildings—and with the relatively low down payments required, this can often be done out of the tax savings alone—he can postpone almost indefinitely the day when his total depreciation deductions will drop below average. Moreover, since most of the buildings concerned are in the same class, a taxpayer who sells a building can avoid recapture of the proceeds by investing them in another building. Finally, if the taxpayer continues this process throughout his life, the tax postponed becomes tax saved forever. When a taxpayer dies, excess depreciation is not recaptured, and the person who inherits the buildings is entitled to depreciate the full fair market value of the buildings, no matter what net book value his predecessor had.

5.17 The government proposes to close this loophole in three ways. First, as mentioned in Chapter 3, a person who inherits property would for tax purposes inherit the tax cost of that property to the deceased. In this case, that would mean that the inheritor starts with the same base for depreciation as the deceased had when he died. Second, a taxpayer would be prohibited from deducting from other income a loss from holding property if that loss is created by capital cost allowance. (It is also proposed that the same restriction be placed on the deductibility of losses arising from holding property if those losses are created by a deduction of interest or property taxes. Otherwise taxpayers could reduce or eliminate the tax on their current incomes by holding large amounts of speculative property.) Finally, it is proposed that a separate depreciation class be created for each rental building that costs $50,000 or more. This would mean that there would be a day of reckoning for the owner of each large building. As each such building is sold the taxpayer would bring back into income the amount by which depreciation deducted for tax purposes exceeds the depreciation actually suffered, or conversely he would get a deduction for tax purposes immediately if he has in fact suffered greater depreciation than he has been allowed for tax purposes.

8.46 For special reasons there are a few types of investment where the after-tax return on investment would be affected in still other ways. Some companies for one reason or another distribute more in dividends in fact reflect a return of capital the If this continued they would not be able to provide the full amount of creditable tax with dividends. The proposed termination of shareholders' depletion on dividends paid by companies in the mineral industry would of course reduce the immediate return on an investment in their shares, but if such divi-

dends in fact reflect a return of capital the new provisions regarding the deduction of capital losses would be available. Implementation of the proposals for the corporate taxation of companies in the mineral industries would presumably be reflected after some years in the after-tax rate of return of those companies and their shareholders, particularly if the company does not carry on enough exploration or development work to earn a depletion allowance on its producing properties. The after-tax return of investment in the ownership of buildings for rent, particularly by those intending to write off book losses on rentals against other income, would be reduced; this is a consequence of closing what has become a serious loophole in the present tax law.

(F) Sale of Shares of Loss Companies

5.19 The government also proposes to require corporations to make this type of write-down in any year in which control of the corporation changes hands. This proposal will help to restrict the sale of business losses.

(G) Professions and Cash Basis of Computing Income

5.46 Generally, taxpayers who are in business must compute their taxable income on what is known as the accrual basis. This means that a merchant must take into account the inventory of goods he has on hand, the amounts due to him from his customers, and the amounts he owes to his suppliers. An exception to this general rule has for many years been made for taxpayers in the professions (doctors, dentists, lawyers, chartered accountants, professional engineers, etc.) These taxpayers have been permitted to choose to report their income either on the accrual basis or on the cash basis—that is, they could omit the amounts due them from their clients and their "inventory" of unbilled time. Once a taxpayer chooses one basis he cannot switch to the other without the consent of the Minister. The government believes that the tax postponement permitted by this concession has given professionals an unwarranted advantage by comparison to the rest of Canadians, and it therefore proposes that professionals be required to use the accrual basis.

Please note: The heading on this and subsequent pages should read: "References to Loopholes and Tax Avoidance" rather than: "Summary of Proposals that would not be effective immediately"

(H) Trusts

5.57 The fact that a trust is entitled to use the personal rate schedule in computing its tax means that income accumulated in a trust may bear significantly less tax than if the income were taxable to the beneficiaries, and the tax saving is not offset by a further tax when the funds are eventually distributed. (The number of accumulating trusts has increased significantly during the past few years.) If a trust is covered by the proposal set out in the preceding paragraph, this loophole would no longer be available. To close it for other trusts, it is proposed that income accumulating in such trusts be subject to a flat-rate federal tax of 40 per cent; provincial taxes would increase this rate to the neighborhood of 50 per cent and the corporate rate. A special relieving provision would reduce the rate in the case of trusts or estates arising on the death of someone whose economic circumstances were such that a 50 per-cent rate is not appropriate, provided no additional property is transferred to the trust by anyone else.

(I) Foreign Income

6.4 Some countries do not levy income taxes. Other countries levy income taxes but do not apply them to particular types of income. Taxpayers, both here and abroad, have not been reluctant to use such jurisdictions to artificially reduce or unduly postpone the Canadian taxes they would otherwise pay. Some types of income (e.g. foreign dividends, rents and royalties, shipping income and some export profits) are easily diverted to the so-called tax-haven jurisdictions. Canadian taxes are thereby at least postponed until the funds are needed in Canada, and may be avoided altogether. In some instances, Canadian income can also be routed through a tax haven to produce a tax advantage. Consider a Canadian corporation contemplating the purchase of a Canadian bond. If it buys the bond itself, the interest will bear corporate tax of 50 per cent. If, however, it causes a wholly-owned corporation in a tax-free jurisdiction to buy the bond, Canada will settle for a 15-per-cent withholding tax on the interest, and the subsidiary corporation can distribute the funds to its Canadian parent corporation tax-free by way of a dividend. A number of the proposals in this chapter are designed specifically to counter such manoeuvres. A number of other proposals call for the restriction to tax treaties of a variety of privileges at present extended to all. In this way conces-

sions can better be confined to those who are intended to benefit.

(J) Sale of Shares of Controlled Foreign Corporations

6.19 Subject to the limitation noted below, the general capital gains provisions would apply to the shares of controlled foreign corporations—gains realized on the disposal of them would be fully taxable and losses fully deductible (except of course to the extent that the gain or loss accrue prior to valuation day). However, because full corporate tax would not be collected on dividends from such corporations it would be necessary to place a limit on the deductibility of losses if the system as a whole is to be effective. Otherwise, Canadian corporations could purchase control of foreign corporations, arrange to receive most of the assets of the company as a special dividend, and then sell the shares for the value of the remaining assets. The dividend would bear little or no Canadian tax because of the foreign tax credit or the exemption, but the loss would reduce taxable income and save Canadian tax. This tax result is clearly inappropriate since the Canadian corporation would not, in fact, have suffered an over-all loss on its investment. To avoid this consequence, it is proposed to reduce the deductible loss on such shares by reference to the dividends received from the corporation that did not bear full Canadian corporation tax.

(K) Passive Income of Controlled Foreign Corporations

6.20 As noted above, the exemption privilege is susceptible to abuse. Not all foreign corporations carry on bona fide business operations. Some are merely devices of convenience to which income from other sources—dividends, interest, royalties and trans-shipment profits—may easily be diverted. The dividend exemption system would permit such income to be brought back to Canada tax-free. Even the tax-credit system would permit the Canadian tax on such income to be postponed indefinitely.

6.21 To counter this type of tax-haven abuse, the United States now provides that when such income is channelled to a controlled foreign corporation, the U.S. controlling shareholders shall be taxed on a current basis whether or not the income is distributed to them. U.S. taxes are levied in the year in which the profits are earned rather than postponed until the profits are returned home. The government proposes to introduce provisions patterned generally on those in the United States. This proposal involves complicated and difficult law, but the problem is serious and defies easy solution.

(L) Foreign Business Corporations

6.31 "Foreign business corporation" is a technical expression for a type of corporation that is exempt from Canadian income tax. To qualify, a corporation must carry on all of its business operations, except management and a few other specified activities, outside Canada. Originally, this category was provided to make sure that several large Canadian public corporations with business operations entirely outside Canada did not suffer "double taxation" on their business profits. It did for these corporations what the exemption system did for corporations that operated abroad through controlled foreign corporations.

6.32 However, during the 1950s other corporations appeared that passed the test for Canadian exemption but were not taxable in any other country either, often because of Canada's tax treaties with the countries with which they traded. Canada had become a tax haven. In 1959 Parliament provided that no new foreign business corporations could be created.

(M) Withholding Taxes

6.35 The high rates in other countries effectively curtail some of the more obvious opportunities for international tax avoidance. The modest rates in Canada have enabled taxpayers to make use of "incorporated pocketbooks", trusts and other devices in tax-haven jurisdictions to artificially reduce the tax load on Canadian-source interest, dividends and royalty payments. The proposal discussed above concerning "passive income" would partially frustrate this opportunity for abuse, but would not eliminate it. A general increase in the rate of the non-resident withholding tax is also necessary.

(N) Thinly Capitalized Corporations

6.41 The Canadian tax system contemplates that non-residents who earn business profits in Canada shall pay income tax to Canada at the rates that apply to Canadians. If a foreign individual carries on business in Canada, he is taxed on the profits in accordance with the normal table of progressive rates. If a foreign

corporation carries on business here, it is taxed on the profits at the corporate rate of 50 per cent. If the foreign corporation incorporates a Canadian subsidiary, the Canadian corporation is taxed on the profits at 50 per cent, provided the foreign corporation makes its investment in the form of shares. If, however, the foreign corporation makes part of its investment as a loan, the interest on that loan is a deduction in computing business profits. It therefore saves tax at 50 per cent, but it bears Canadian tax only at the withholding rate of 15 per cent (or 25 per cent if not protected by treaty). It is a natural thing for corporations to borrow, and not unnatural for them to borrow from their shareholders, but the difference in tax rates has tempted some to create corporations with very nominal share capital (say $3) and to make virtually all of their investment as an interest-bearing loan.

6.42 No country has yet found a satisfactory tax solution to this "thin-capitalization" problem, although a number of other countries rely extensively on investment restrictions and currency controls to thwart abuse. The government proposes to restrict the deductibility of non-arm's-length interest wherever the ratio of shareholder debt to equity exceeds three to one. Such a provision is necessarily arbitrary and it is difficult to administer. It may have to be altered at a later date in the light of experience.

(O) Capital Gains and Non-Residents

6.46 This is the appropriate result provided the vendor is taxable on his capital gain on the sale of the share. He and/or the owners before him would have paid tax on the full $60,000 on the sale of their shares. Canada would have collected one tax—and only one—on the $60,000. But the vendor must be taxable, or the $60,000 would escape tax. Therefore it is proposed that non-residents as well as residents be taxed on their gains on the sale of shares of closely-held Canadian corporations. This would be buttressed by a "back-up" provision to place a responsibility on the purchaser to ensure compliance. A system of "certificates of compliance" would be necessary for private company share transfers—an awkward but necessary evil.

APPENDIX "D"

SPECIAL STUDY NO. 3

COMPARISON OF PRESENT TAX RATES WITH PROPOSED TAX RATES

SPECIAL STUDY NO. 3 COMPARISON OF PRESENT AND PROPOSED TAX RATES

This study seeks to compare the present net federal taxes and provincial taxes computed at 28 per cent of the basic federal tax with the proposed federal taxes and provincial taxes computed at 28 per cent of the proposed federal taxes.

While both schedules are based on taxable income, it should be realized that taxable income on which the proposed taxes will be based will be generally $550 and $950 less than at present.

The increased deductions from taxable income are referred to in the following paragraphs of the White Paper:

1.32 The government has examined the deductions individuals may claim for various costs they incur, as well as differences in treatment between taxpayers who are employed and those who carry on a business or profession. The royal commission said many employees have been over-taxed because they have been denied the deduction of almost all expenses incurred in earning wages and salaries. But millions of taxpayers are involved, and a very wide range of expenses could be related to earning their employment income. These taxpayers do not keep detailed records. The government has found no practical way to permit employees to deduct actual costs as do those carrying on a profession or other business. We propose to provide employees with a general deduction to cover expenses, in addition to certain specified deductions. The amount would be 3 per cent of employment income, up to a total of $150 a year. This could benefit more than 6,500,000 persons, the great majority of them earning less than $10,000 a year.

2.4 These factors led the government to propose an increase in personal exemptions to $1,400 from $1,000 for single taxpayers (or married taxpayers filing as single) and to $2,800 from $2,000 for married taxpayers filing as such. The deductions for children and other dependants would remain the same, although some of the conditions relating to them would be changed as noted below. These new exemptions plus the $100 standard deduction, which would be continued, would mean that those entitled to the married exemption would be exempt up to an income of $2,900 and single persons to $1,500. These increases would free from income tax about 750,000 persons now subject to tax.

At $7,041 of present taxable income, a married taxpayer loses the benefit of the increased deductions. An unmarried taxpayer loses the benefit at $2,310 of present taxable income.

It should be pointed out that the proposed provincial taxes are based on the assumption that provinces will base their taxes at 28 per cent of federal taxes. At the present time, the taxes imposed by the provinces are:

Newfoundland 30.5 per cent of basic federal tax

Prince Edward Island and Nova Scotia 28 per cent of basic federal tax

New Brunswick 38 per cent of basic federal tax

Quebec 50 per cent of basic federal tax

Ontario 28 per cent of basic federal tax

Manitoba 39 per cent of basic federal tax

Alberta 33 per cent of basic federal tax

British Columbia 28 per cent of federal tax

Saskatchewan 34 per cent of basic federal tax

Where taxable income exceeds $24,000, the proposed rates of federal tax shown in the attached schedule will be reduced:

(a) In year 2, after the new schedules are applied, the excess of federal taxes over 40 per cent and of combined taxes over 5.20 per cent will be reduced by 25 per cent.

(b) In year 3, after the new schedules are applied, the excess of federal taxes over 40 per cent and of combined taxes over 5.20 per cent will be reduced by 50 per cent.

(c) In year 4, after the new schedules are applied, the excess of federal taxes over 40 per cent and of combined taxes over 5.20 per cent will be reduced by 75 per cent.

(d) In year 5, after the new schedules are applied, the excess of federal taxes over 40 per cent and of combined taxes over 5.20 per cent will be reduced by 100 per cent.

COMPARISON OF

Present Net Federal Taxes and Present Provincial Taxes Computed at 28% of Basic Federal Tax					with			
					Proposed Net Federal Taxes and Proposed Provincial Taxes Computed at 28% of Proposed Net Federal Taxes			
	Present Net Federal Taxes		Present 28% Provincial Tax		Proposed Net Federal Taxes		Proposed 28% Provincial Tax	
Brackets of Taxable Income	Tax Payable at beginning of bracket	Rate of Tax within bracket	Tax Payable at beginning of bracket	Rate of Tax within bracket	Tax Payable at beginning of bracket	Rate of Tax within bracket	Tax Payable at beginning of bracket	Rate of Tax within bracket
$ 0 to $ 500	$ 0	11.72%	$ 0	3.08%	$ 0	17%	$ 0	4.76%
500 909	59	11.72%	15	3.08%	85	18%	24	5.04%
$909 is point at which the present 20% credit equals $20								
909 1,000	107	13.92%	28	3.08%	159	18%	44	5.04%
1,000 1,500	119	16.08%	31	3.92%	175	19%	49	5.32%
1,500 1,643	200	16.08%	50	3.92%	270	20%	76	5.60%
$1,643 is point at which tax equals $200 and 3% temporary surtax applies.								
$ 1,643 to $ 2,000	$ 223	16.50%	$ 56	3.92%	$ 299	20%	$ 84	5.60%
2,000 3,000	281	18.75%	70	4.76%	370	21%	104	5.88%
3,000 4,000	469	20.25%	118	5.32%	580	22%	162	6.16%
4,000 5,000	671	22.50%	171	6.16%	800	24%	224	6.72%
5,000 6,000	896	22.50%	232	6.16%	1,040	26%	291	7.28%
$6,000 is the point at which the Old Age Security tax and Social Development tax reach maximums of $240 and $120								
6,000 7,000	1,121	19.50%	294	7.28%	1,300	26%	364	7.28%
7,000 8,000	1,316	19.50%	367	7.28%	1,560	28%	437	7.84%
8,000 10,000	1,511	22.50%	440	8.40%	1,840	28%	515	7.84%
10,000 12,000	1,961	26.25%	608	9.80%	2,400	30%	672	8.40%
12,000 13,000	2,486	30.00%	804	11.20%	3,000	30%	840	8.40%
$ 13,000 to $ 15,000	$ 2,786	30.00%	$ 916	11.20%	$ 3,300	33%	$ 924	9.24%
15,000 16,000	3,386	33.75%	1,140	12.60%	3,960	33%	1,109	9.24%
16,000 24,000	3,724	33.75%	1,266	12.60%	4,290	36%	1,201	10,08%
24,000 25,000	6,424	33.75%	2,274	12.60%	7,170	40%	2,008	11.20%
25,000 35,000	6,761	37.50%	2,400	14.00%	7,570	40%	2,120	11.20%
35,000 40,000	10,511	37.50%	3,800	14.00%	11,570	44%	3,240	12.32%
40,000 55,000	12,386	41.25%	4,500	15.40%	13,770	44%	3,856	12.32%
55,000 60,000	18,574	41.25%	6,810	15.40%	20,370	48%	5,704	13.44%
60,000 85,000	20,636	45.00%	7,580	16.80%	22,770	48%	6,376	13.44%
85,000 90,000	31,886	45.00%	11,780	16.80%	34,770	52%	9,736	14.56%
90,000 120,000	34,136	48.75%	12,620	18.20%	37,370	52%	10,464	14.56%
$120,000 to $125,000	$ 48,761	48.75%	$ 18,080	18.20%	$ 52,970	56%	$ 14,832	15.68%
125,000 200,000	51,199	52.50%	18.990	19.60%	55,770	56%	15,616	15.68%
200,000 225,000	90,574	52.50%	33,690	19.60%	97,770	60%	27,376	16.80%
225,000 400,000	103,699	56.25%	38,590	21.00%	112,770	60%	31,576	16.80%
400,000 and up	202,136	60.00%	75,340	22.40%	217,770	64%	60,976	17.92%

Queen's Printer for Canada, Ottawa, 1970

Second Session—Twenty-eighth Parliament

1969-70

THE SENATE OF CANADA

PROCEEDINGS

OF THE

STANDING SENATE COMMITTEE

ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 8

WEDNESDAY, FEBRUARY 11th, 1970

Fourth Proceedings on the Government White Paper, entitled:

"PROPOSALS FOR TAX REFORM"

APPENDICES:

"A"—Addenda to Special Study No. 3 (see Issue 7, Feb. 4, 1970.)

"B"—Taxation of Dividends.

"C"—Present and proposed net Federal and Provincial tax comparisons for the 2nd, 3rd, 4th and 5th years; plus tax on dividends received by individuals from Canadian widely-held companies.

21622—1

THE STANDING SENATE COMMITTEE ON

BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aseltine	Desruisseaux	Kinley
Beaubien	Everett	Lang
Benidickson	Gélinas	Leonard
Blois	Giguère	Macnaughton
Burchill	Grosart	Molson
Carter	Haig	Phillips (*Rigaud*)
Choquette	Hayden	Walker
Connolly (*Ottawa West*)	Hays	Welch
Cook	Hollett	White
Croll	Isnor	Willis—(30)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

"With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intituled: "Proposals for Tax Reform", prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

"With leave of the Senate,

The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative."

ROBERT FORTIER,
Clerk of the Senate.

21622—1½

MINUTES OF PROCEEDINGS

WEDNESDAY, February 11th, 1970.
(10)

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to further consider:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Hayden (*Chairman*), Beaubien, Benidickson, Blois, Burchill, Carter, Connolly (*Ottawa West*), Cook, Desruisseaux, Flynn, Everett, Giguere, Grosart, Haig, Hays, Hollett, Isnor, Kinley, Lang, Leonard, Macnaughton and Phillips, (*Rigaud*)—(22).

Present, but not of the Committee: The Honourable Senators Aird, Phillips (*Prince*) and Sullivan—(3).

In attendance: Arthur W. Gilmour, Senior Advisor; Alan J. Irving, Legal Advisor; R. Breton, Executive-Secretary.

Mr. Gilmour presented an explanation to the Committee of charts lettered A, B, C and D respectively together with an addendum to special study 3 printed in issue 7 of the Committee comprising comparison tax rates for the second, third, fourth and fifth years of implementation which also included Taxes on dividends received from Canadian widely held corporations; following which a general discussion took place.

Ordered:—That the above mentioned documents be printed as appendices "A", "B" and "C" to these proceedings.

At 12:00 Noon the Committee adjourned to the call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

ERRATUM: The Title Page of Issue No. 7 dated Wednesday, February 4th, 1970, *should read as follows:*

"*Third* Proceedings on the Government White Paper,"
NOT
"Second Proceedings on the Government White Paper,"

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

**Wednesday, February 11, 1970,
Ottawa, Ontario.**

The Standing Senate Committee on Banking, Trade and Commerce, met this day at 10.40 a.m. to give further consideration to the White Paper entitled "Proposals for Tax Reform".

Senator Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: Mr. Gilmour, would you indicate in outline what you propose to deal with this morning?

Mr. Arthur Gilmour, Special Tax Adviser: Honourable senators, I would like to deal with three aspects this morning if possible. The first is the answer to certain questions that were raised at our meeting of February 4. I have not yet had time to prepare the three studies requested by Senator Phillips (Rigaud). That requires correspondence with the United Kingdom and other countries. There were also certain other questions asked at our last meeting. Yesterday afternoon I had certain rather strange looking charts distributed to you. These should be inserted at the after-end of the Special Study No. 3. I will refer to the charts extremely briefly.

The first one, which looks rather like an ice castle that used to be built when we were youngsters, indicates the type of pyramid formed by taxpayers in Canada. This particular chart shows the number of taxable returns by income classes for the year 1967. They are the latest available statistics. It shows that the number of individuals who filed tax returns total 6,655,000. In the bracket of under $3,000 income there are 1,665,000 taxpayers, far and away the biggest group. In the second tier, between $3,000 and $4,000, there are 1,026,000. The reason for the peculiar jog roughly two-thirds of the way up is that we have there a taxable bracket from $12,000 to $15,000. I asked the Chief Statistician of the taxation division if I could have that bracket broken down to preserve the symmetry, if you like, but I was told that their computers are set in a certain way and this is all they could produce.

Towards the tip there is something rather like a TV antenna, representing those who have incomes between $50,000 and $100,000, and there are 7,000 such fortunate individuals in Canada. In the $100,000 to $200,000 bracket there are 1,000 persons, and there are 140 persons with incomes of $200,000 and over. This gives an idea of the pyramid of our taxpayers.

Senator Burchill: Over what period do they estimate the figure of 750,000 who will be removed from the tax role? That number would change over the years, would it not?

Mr. Gilmour: It certainly will. It has probably changed now from the estimates that were made.

Senator Burchill: Is this based on one year?

Mr. Gilmour: Based primarily on the year 1967.

Senator Phillips (Rigaud): Contemporized, however, to 1969 income?

Mr. Gilmour: Yes. With respect, the estimates on which the computations are made strike a former tax collector like myself as being rather theoretical.

Senator Everett: In this chart, what do you define as income?

Mr. Gilmour: According to the statistics from which this chart was prepared, income is salary or professional income. It is not taxable income; taxable income being income less deductible expenses, less the statutory exemptions resulting from such things as marital exceptions.

The Chairman: In this list, particularly in the lower dollar amounts, many of these persons described as taxpayers may not in fact

have had any taxable income and therefore would not have paid any tax. Is that right?

Mr. Gilmour: According to the published statistics, it is the number of taxable returns. Therefore, for a single man with an income of $3,000 or under, the exemptions in this year would be $1,100, so there would be some tax payable in that lowest bracket. The White Paper proposes to remove roughly half of the lowest bracket, which has 1,665,000 taxpayers. We are told that roughly 750,000 will be removed, and presumably they would come out of that lowest bracket.

Senator Carter: Are we to understand that every one of these 1,665,000 actually paid tax? They actually paid tax, and it is not just those who submitted tax returns?

Mr. Gilmour: That is correct, according to the taxation statistics. For all these charts I have used as my basis the published taxation statistics, 1969 edition, based on the actual 1967 tax returns.

Senator Hays: Further to Senator Everett's question, this is all the taxable revenue they received, 100 per cent, less the exemptions?

Mr. Gilmour: The first chart is the number of taxable returns. This is not a dollar figure. These are the individuals who paid anything from $1 up to something fairly high.

The Chairman: It is whatever they had in the way of income.

Senator Hays: The statistics we received showed 16,500 in the medical profession earning an average of over $27,000, and in the legal profession 8,500 earning an average of $22,000. There are only 81,000 earning above $25,000, or paying tax on $25,000 or more.

Mr. Gilmour: In the income range between $15,000 and $20,000 there are 81,600 individuals.

Senator Hays: One notch further up a small number earn over $20,000.

Mr. Gilmour: Out of 6,600,000 individuals, 31,000 are in the range between $20,000 and $25,000. There are roughly 40,000 in the range from $25,000 to $50,000. Those are the numbers of individuals.

Senator Leonard: Could I ask you to check my addition, Mr. Gilmour. There are more taxpayers with taxable incomes under $5,000 than there are taxpayers with taxable incomes of over $5,000. Is that right?

Mr. Gilmour: That is correct, senator.

Senator Leonard: The majority of income tax payers have a taxable income of $5,000 or under.

Mr. Gilmour: Income.

Senator Carter: That is gross income.

Senator Leonard: No, taxable income after all deductions.

The Chairman: No.

Mr. Gilmour: On this chart I have drawn only income before deducting the personal exemptions. There are roughly 3,700,000 taxpayers whose income before deductions is under $5,000.

Senator Leonard: That is a majority of the 6,655,000.

Mr. Gilmour: Yes, sir.

Senator Carter: That is in 1967. The $5,000 level would be right under the line.

Mr. Gilmour: It makes you realize what a poor country, in the sense of income, that we Canadians are when you look at this chart.

Senator Leonard: We are not so poor, but some are.

Senator Lang: What is your guess, Mr. Gilmour, for the peculiar bulge in the $12,000 to $15,000 range?

Mr. Gilmour: Most of the lower ranges, as you notice, have moved up $1,000. We then get the last $1,000 range, which is $11,000 to $12,000 and then we suddenly jump from $12,000 to $15,000. This is because the taxation division prepares its statistics in this way. We tried to get a further breakdown and if we had been able to I am sure the pyramid would have been quite symmetric, but we just could not obtain it. As I said, this bracket ends up looking like a turret half way up.

The Chairman: It looks like a nightmare. Shall we move on to the next exhibit?

Mr. Gilmour: The next chart is marked with a large B in the lower right-hand corner. This is a rather peculiar collection of taxes. It

does not show us everything we would like to see, but it is the best I can produce. This shows the federal individual income taxes, the Old Age Security taxes, which are both federal taxes, and then the provincial income taxes that are collected for the agreeing provinces by income classes, which of course excludes Quebec.

Starting at the left of this vertical chart, in the income range from zero to $3,000—by the way these are the same ranges shown in the pyramid chart—the total tax paid there by these 1,665,000 individuals is $164 million. Therefore, looking at the chart, the chaps who have less than $3,000 income have paid a substantial sum, but it changes quite quickly and we find the group that pays the largest total sum of dollars is in the range from $6,000 to $7,000 of income. In total, they pay the most. Then the other peak is in the range from $25,000 to $50,000. You will notice that we have a spread of $25,000 in the $25,000 to $50,000 bracket compared to the other brackets which are spreads of roughly $1,000, so that the amounts shown on the chart are distorted because of the varying ranges. It would have been better if we could have gotten the statistics broken down on a comparable basis, but we cannot.

When we look to the far right, the fortunate individuals who have over $200,000 income pay in total $15 million of tax and inasmuch as there are only 140 of these gentlemen, the individual taxes are fairly steep.

With your permission I would like to also refer to schedule C.

The Chairman: Before you leave chart B could I ask you this question: it would appear that you had 1,665,000 people having income under $3,000 and that they paid $164.9 million in taxes. That works out to less than $1 apiece, does it not?

Mr. Gilmour: Could I answer by referring to chart C?

The Chairman: Yes.

Mr. Gilmour: Chart C is really a component of chart B and again it shows the same brackets of income. I have attempted to determine the average tax paid within a bracket. The average is subject to all of the errors of averages, but from $3,000 down—that is starting with the lowest range of chart C—the average tax paid by these 1,665,000 individuals is roughly $100. You and I both make errors in our decimals, senator.

The Chairman: That is right.

Mr. Gilmour: The average taxable income for those people in the $3,000 and under bracket is $797 during the year 1967. In the $3,000 to $4,000 income bracket the average tax is $253 and, as you can see, the average tax builds up. When we get into the range of $6,000 to $7,000—that was the range in which a total of $472 million tax was paid which is the highest single range of the total tax—you find that of the 689,000 individual taxpayers, that their average tax is $685 and their average taxable income is $3,981 or roughly $4,000. As we move up in these tables and look to the bottom tier of $200,000 and over there were 140 individuals. They pay, on the average, $107,000 each in tax, and their average taxable income is $261,000. So we have certainly carried progressive taxation to its limit. As you can see, the chart itself really starts from zero and builds up to a very high figure.

May I proceed to Schedule D? Schedule D was put in as a curiousity. I would imagine that you would, as I did, challenge the accuracy of these figures; but they have been checked. This schedule shows that persons who are entitled to unmarried status in Canada are roughly two to one of persons who claim marital status. Unless the statistics lie—and I am certain they do not—we have the peculiar position that we have four million of our taxpayers who claim unmarried status and 2.6 million who claim married status.

I would assume that this comes about through two basic causes. In the lower ranges I imagine this is caused by working wives. If the wife has an income beyond $1,000, roughly, then the husband is entitled to claim only unmarried status. Then, probably in the upper brackets, husbands who may be the chief earner, will have made gifts of capital to their wives—obviously, except in Quebec—or transfers of some sort. Perhaps there are others who were fortunate enough to have married a wealthy wife who had an independent income. In either case this would cause a man, even though he had numerous legitimate children, to be classed as unmarried for tax purposes.

Schedule D does not prove anything, but I thought you would be interested.

Senator Phillips (Rigaud): Unless it proves some wisdom on the part of some of the single people?

Mr. Gilmour: It may, senator.

Then, honourable senators, with your permission, I would like to distribute some documents I brought up this morning. I would ask you to place these charts as the last pages of the special study No. 3 that we looked at at our meeting of February 4.

I have numbered the documents for the last pages of study 3. The documents are marked 7a, 7b, 7c, 7d. They come about from a request which Senator Everett made. I show you the reduced rate of tax that hopefully will apply in the second, third, fourth and fifth years of the new system. Table 7a shows the proposed reduced rate of taxes in the second year, that will apply to incomes above $24,000. Table 7d shows the figures in the third year, and so on. These simply indicate the changes that are proposed to be made in future years.

Senator Everett: I notice that both you and the White Paper refer to $24,000 as the point at which that break comes, that is, where the federal Government levy is in excess of 40 per cent. Yet, if you go down to the chart you go through—is it $25,000—before you have any reduction. I wonder if there is any significance in that. For example, you have $25,000 but you notice that the White Paper makes a specific reference, I think, to $24,000, does it not?

Mr. Gilmour: It shows a bracket of $24,000 to $35,000. On page 25 of the White Paper, about the centre of the page. There is a note:

> In the first year of the new system the additional brackets will be as set out below. In each of years two, three, four and five, each rate will be reduced by one-quarter of the excess over 40 per cent and 51.2 per cent.

In my table No. 7a I have used different brackets than are shown in the White Paper. The only reason I used a different bracket is that I was trying to make a comparison between the present brackets in our Income Tax Act...

Senator Everett: Right.

Mr. Gilmour: ...that are divided in a different way. So to keep comparable figures we broke up the brackets shown in the White paper.

Senator Everett: What I did not understand is this. It would seem to me that the rate in the second year on an income below $35,000 is already at a maximum 40 per cent.

Mr. Gilmour: Yes.

Senator Everett: Why did the White Paper include the bracket $24,000 to $35,000 on page 25? I become suspicious of the White Paper. When they make a mistake I start to look for reasons.

Mr. Gilmour: We have been wondering the same thing. Not being the author, I cannot answer you, but frankly it would seeem to us that the authors of the White Paper have dealt in generalities, and I do not think that they have got down to the detail they should. After all the 40 per cent rate runs up to $35,000 and continues right through the taxes for the five years.

Senator Leonard: The first line of the bottom tabulation on page 25 might well be the last line of the top tabulation.

Mr. Gilmour: That is correct.

Senator Leonard: It shows no reduction until you get to $35,000 taxable income.

Senator Everett: In case there is some hidden meaning, I wonder if that should be a question to the Department of Finance. Should we find out whether they meant anything by it?

The Chairman: Have you any suggestions, Mr. Gilmour?

Senator Leonard: Honi soit qui mal y pense.

Mr. Gilmour: I am afraid that shortly I shall have some such thoughts, but I have no thoughts on these schedules, gentlemen. As I said last week there seems to be very little rhyme or reason in these proposed schedules other than a possible desire to soak the people with larger incomes.

Now, honourable senators, there is a table marked number 8 which has been distributed to you. This arises from the question which I think was asked by Senator Phillips (Rigaud) as to whether we could make some kind of estimate of what the effect of federal and provincial taxes would be where the tax payer receives investment income as distinct from earned income.

The Chairman: I raised that.

Mr. Gilmour: We prepared schedule 8, and I took the liberty in order to make this thing understandable, of contrasting what the present system of taxing dividends is with the proposed system of taxing dividends and bringing out what I trust is an error of judgment rather than an ulterior motive. At the top of the page you will see that under our present system dividends received by individuals from taxable Canadian corporations are taxed according to the following formula. Then you have two columns showing the federal and provincial taxes. I have assumed that the individual receives dividends equivalent to 100. Under our present system the federal tax would be computed on the graduated rates based on 100. The tax on the dividends received could then be reduced by the 20 per cent of the dividend received. That would result in a figure that is referred to as the basic federal tax. Then 28 per cent of the basic federal tax is allocated as a credit to the province.

Then we add the social development tax and the old age security tax and other things that I simply call sundry surcharges. Under our present system, the 20 per cent dividend credit allocated to the province in full in the 28 per cent credit. Under our proposed system which is shown on the lower half of the sheet, the dividends received by an individual from Canadian widely-held corporations will be taxed according to the following formula. Again we assume a dividend received equivalent to 100. The first thing that will happen is the taxpayer has to add a taxable credit of half the amount of the dividend. Therefore instead of starting with a taxable base of 100, you start with a taxable base of 150. Then you apply the taxes according to the new schedules. They are largely increased taxes, so that you pay tax on 150 and get a credit for the corporate tax that has been paid by the corporation. Then because Canada gives a credit to the provinces of 10 per cent of the 50 per cent corporate tax collected, under our new system Canada will give you a credit of 40 per cent of the dividend and the province will give you 10 per cent of the dividend. Under the old system, you paid tax on the dividend itself and you deducted a credit from the tax of 20 per cent of the dividend. Under our proposed system you will pay tax on 150 per cent of the dividends and you will deduct from the tax 40 per cent of the dividend. But when you turn to the province, you will be paying 28 per cent of the federal tax on 150 per cent of the dividend and you will be getting a deduction of 10 per cent of the dividend. So we have a series of distortions that make it pretty difficult if not impossible to make a *bona fide* comparison of the two. I have pointed out on page 9 that under our present system, the individual is given a credit of 20 per cent of the total Canadian dividends received when computing his liability for federal and provincial income taxes.

Under the proposed system, the individual is taxed on 150 per cent of the total dividends received from Canadian widely-held corporations and is given a credit of 40 per cent of the dividends received when computing federal taxes and is given a credit of 10 per cent of the dividends received when computing provincial taxes.

The Chairman: In the samples in the White Paper the figures used are 50 per cent and not 40 per cent.

Mr. Gilmour: They use 50 per cent but the wording is garbled, with all due respect to the authors, and they have assumed that you are paying an average rate of tax that combines federal and provincial taxes. Then you have to work backwards in the tables that show 50 per cent to get the division between the federal and provincial. That is what we have done in our own schedules that are placed before you.

The Chairman: This is on page 51, I think, of the White Paper.

Mr. Gilmour: Yes. On page 51 of the White Paper, in paragraph 4.37, about the centre of that, it states:

> A shareholder who receives a dividend of $100 would therefore report $150 as the income from the corporation and would show on his return that $50 tax has been paid by the corporation, $40 federal and $10 provincial. If his marginal tax rate is 40 per cent...

That is a combined tax rate, as you find when you analyse it, and I think it works out to a federal tax of about 26 per cent, and a provincial tax of the balance, 13-odd per cent.

Paragraph 4.37 continues:

> the tax on the dividend would be $60.

This is the combined federal and provincial tax, so that he would owe the two governments $10. I think this is about $8 federal and $2 provincial.

Continuing on page 9:

> The White Paper makes no proposals respecting the corporation taxes in excess of 10 per cent presently levied by most provinces, but assumes that all provinces will reduce corporation taxes to a standard rate of 10 per cent.

I have heard it suggested that that is a pious hope.

To try to make some of these computations more meaningful, I have attached a schedule contrasting the federal and provincial taxes payable on certain amounts of earned income and on dividend income under our present and proposed systems.

If I might refer to the top of page 10, I have assumed the case of an unmarried taxpayer with no dependants—in other words, a man who forms two-thirds of the Canadian taxpayers.

If I could interrupt for a moment, Mr. Nutt advises me that the 40 per cent that was referred to on page 51 is: federal 31.2 per cent; and the 28 per cent provincial tax of 7.8 per cent. That is how the 40 per cent was arrived at.

Senator Leonard: That is only 39 per cent!

Senator Cook: It is a 1 per cent discount!

Mr. Gilmour: I will give you the correct figure in a moment. I am glad to say my human computer is not infallible. It is 8.8 per ment. I am sorry.

Senator Leonard: It is 31.2 per cent and 8.8 per cent?

Mr. Gilmour: Yes. This is the first time I have caught him out in the last 20 years.

The Chairman: He is entitled to one break, anyway.

Mr. Gilmour: On page 10 I have shown the case of an unmarried taxpayer with no dependants. In the first section I have assumed his income is earned, and he has a salary income or professional income of $5,000.

Under our present law that wage earner would pay a Canadian tax of $651, and he would pay a 28 per cent provincial tax of $16, or a total of $817.

Under our proposed system his federal tax would be $657, his provincial tax $184, or a total of $841.

Therefore his Canadian tax on his earned income tax has gone up by $6. Six dollars may not seem too large in sum but it is on an earned income of $5,000.

Senator Beaubien: Is that in the first, second, third, fourth or fifth year of operation?

Mr. Gilmour: This is the first year, and it would be so for every subsequent year because it is only taxes on incomes above $24,000 that change.

Senator Beaubien: Thank you.

Mr. Gilmour: So the individual with $5,000 earned income will be paying the $6 more to Canada and $18 more to the province, or a total of $24.

Then when you move to an income of $10,000 you will notice that he pays to Canada $225 more, $26 more to the province, or a total of $251.

Senator Cook: That $18 and $26 provincial tax does not change much when the province levies a higher rate than 28 per cent?

Mr. Gilmour: Not very much, senator. The province today would collect $516, and it will collect $542, so that the spread is $26, but there is quite a difference between the federal increase of $225 and the provincial increase of $26.

The Chairman: The proposed rate calculation includes the allowance for the increased exemption?

Mr. Gilmour: Yes.

The Chairman: It would be $400—$150 for employment expense, $100 for medical and charitable donations, et cetera. No, you have that already, so it is $550, so, for $550 of increased exemption it costs him an increase in taxes of $251. Is that a fair way of looking at it?

Mr. Gilmour: I believe that is the correct way of looking at it. That comes about because this is the unmarried taxpayer.

Senator Everett: What is the deduction under the present act for an unmarried man?

Mr. Gilmour: $1,000, and then a blanket $100 for charitable donations and medical expenses, so it is $1,100 for an unmarried man.

Senator Everett: I am trying to make some comparisons here, but I do not quite understand. You show an earning of $25,000. On page 3 of your comparison that would be, presumably, a taxable income of roughly $24,000, giving rise to a tax of $6,390. On page 3 of your study you show that a taxable income of $24,000 results in a federal tax of $6,400, whereas here you show it as $8,600.

Mr. Gilmour: I am sorry. Would you repeat the first figure?

Senator Everett: I am looking at Study No. 3—the comparison of present taxes with the proposed taxes for the first year. I am looking at the top right hand of page 3. It shows that if you have a taxable income of $24,000 your present tax would be $6,424.

Mr. Gilmour: Yes.

Senator Everett: However, on page 10 you show that if the earned income is $25,000, which you state would be roughly a taxable income of $24,000—actually, it is $23,900—the tax payable would be $8,600, which is a difference of $2,200.

Mr. Gilmour: The figure of $8,651 is the combined Canadian and provincial tax.

Senator Everett: I see. So I have to add those two figures from page 3 together?

Mr. Gilmour: Yes, and I trust that they will come to the same thing.

Senator Everett: I hope so.

Mr. Gilmour: Otherwise my computer will have made two mistakes.

Senator Everett: That tax of $8,651 is reduced by $5,000, giving you a tax of $3,501, and that is on account of the 20 per cent dividend credit?

Mr. Gilmour: Yes.

Senator Phillips (Rigaud): Would you repeat what you said, Senator Everett?

Senator Everett: The figure of $8,651 on earned income would be reduced by 20 per cent of the $25,000 if the income were dividend income, which results in a reduction of $5,000 down to the figure of $3,501 that is mentioned on Table 10.

Mr. Gilmour: It might assist, senator, if I refer you to the bottom line on page 10. The bottom section here assumes the case of an unmarried individual who has solely Canadian dividend income.

On the $25,000 of Canadian dividend income shown on the bottom line the federal tax due to the operation of the 20 per cent dividend credit is $2,640, as compared to the federal tax on earned income of $6,390. Then the provincial tax on earned income is $2,261, whereas the provincial tax on $25,000 of dividend income is $861.

This comes about by the fact that the 20 per cent Canadian dividend credit under our present law is allocated in total to the province, so that all provinces give the 20 per cent Canadian dividend credit. My own Province of Quebec gives us half of this credit. They levy a tax equal to a half of the federal tax so they give us half of the 20 per cent dividend credit. Ottawa gives us half of the 20 per cent dividend credit, so we end up with complete parity.

The next column on page 10 shows the taxes payable under our proposed system. If I may refer to that income of $25,000 again, if this were earned income the taxpayer would pay $546 more to the federal Government, and he would pay $319 less to the provincial Government.

Senator Burchill: May we stop right there? I am confused a bit. The top figure on page 7c...

Senator Phillips (Rigaud): No, we are looking at page 10.

Senator Burchill: Yes, but the same figures are there. According to page 7a, a man with an income of $25,000 pays $6,424 in federal taxes, and $2,274 in provincial taxes. Under the proposed rates he is going to pay $7,170 federal tax and $2,008 provincial tax. Is that right? Do you follow me there?

Mr. Gilmour: Yes.

Senator Burchill: Each is under the heading of "28 per cent provincial tax". If the taxpayer pays $7,170 under the proposed taxes, and there is a 28 per cent provincial tax on that, why should the amount paid in provincial taxes, $2,008, be less than what is paid in provincial taxes at the present time?

Mr. Gilmour: I would first point out, senator, that the amounts shown on page 7c or 7d, to which you refer, are not strictly comparable to the amount shown on page 10. The variance is this. In the top line of page 7c we have shown a taxable income of $24,000. That

is not gross income. That would be equivalent to a gross income of $25,100. On a gross income of $25,100 you would pay a federal tax under our proposed system of $7,170 and, as you pointed out, a provincial tax of $2,008.

Senator Burchill: Yes.

Mr. Gilmour: Referring to page 10, we have an earned income of $25,000, which would actually be a taxable income of $23,900. The tax on $23,900 naturally is less than the tax on a taxable income of $25,000, so we are dealing with two different assumptions.

Senator Burchill: It is the amount of the exemption that makes the difference.

Mr. Gilmour: That is correct. On page 10 showing taxes payable under our present laws on $25,000, we have assumed an exemption of $1,100 to an unmarried man. Moving into the centre computation, which is the tax under the proposed system, we have assumed an exemption of $2,650. Then we show that such an individual making a gross salary of $25,000 pays increased Canadian tax of $546 and decreased provincial taxes of $319. This, presumably, is one of the causes for the concern of the provinces, because this means that at roughly $13,000 taxable income the provinces' take starts sliding downhill as compared to our present system.

The Chairman: This might be entitled, I suppose, "part of the unexplained". It seems to me that there is a radio program under that title.

Senator Connolly (Ottawa West): I think Mr. Gilmour did discuss that part last week, did he not?

The Chairman: Yes, but this time we have broken it down between earned income and dividend income.

Senator Carter: Did you establish the level of earned income where the province breaks even?

The Chairman: We did that last week.

Mr. Gilmour: Thirteen thousand dollars of taxable income was the breakdown point after which the provincial take started sliding downhill.

Senator Carter: It is somewhere between $10,000 and $13,000?

Mr. Gilmour: Yes. You will notice if you refer to the schedule given to you last week, Study No. 3, in the upper right hand corner there is a page with the typewritten number 3. It contains a column headed brackets of taxable income, $13,000 to $15,000. You will notice that the provincial tax under our present system is $916 and the proposed provincial tax is $924, almost the same. Then, when we move to the $15,000 bracket you will notice the provincial tax under the proposed system starts to decrease. The actual breaking point is around $13,000.

Senator Cook: This means, in effect Mr. Gilmour, that when the capital gains tax becomes operative, assuming it applies on the incomes, the provinces' share of the capital gains tax would be much less than the federal?

Mr. Gilmour: Yes, sir, presupposing of course that the provinces will adopt capital gains taxation, which I guess is a foregone conclusion if Ottawa does so.

Senator Connolly (Ottawa West): In addition to the capital gains tax imposed by the federal Government?

Mr. Gilmour: That is the proposal of the White Paper.

Senator Cook: Would they not get the same share of the capital gains as they do of the income?

The Chairman: It will all be income.

Senator Cook: Yes, but under this assumption their share becomes much less because it is the capital gains plus, we assume, the people with incomes of $10,000 and up.

Mr. Gilmour: That is correct. If I might refer finally to the bottom line of page 10, we have the case of an individual who has $25,000 of Canadian dividend income. Under our present law with the 20 per cent dividend credit he would pay a federal tax of $2,640 and a provincial tax of $861. Under our proposed system this individual with a $25,000 dividend income would pay a federal tax of $2,010. In other words, he is paying $630 less to the federal Government and he would pay an increased provincial tax of $2.

For lack of time I have not extended this schedule. However, it does show the remarkable situation that from the $25,000 bracket up the federal take goes up, but the provincial take goes up a great deal further because of the fact that the province under this proposed

ideal system gives credit only for 10 per cent of the dividend. You are going to find that the person who has investment income is going to pay a lot more provincial income tax when he is in the upper brackets.

Senator Cook: And particularly if the provincial rate is more than 28 per cent.

Mr. Gilmour: Yes, it works out in this way: you are paying tax on 150 per cent of the dividend and you are getting a credit of only 10 per cent of the dividend. This is—well, I guess you could call it an anomaly in these tables.

Senator Cook: You can call it something more than that as far as I am concerned.

The Chairman: It is an anomaly that hurts.

Mr. Gilmour: Gentlemen, I had hoped today to deal with the two most complex and lengthy provisions in the White Paper, comprising the taxation of dividends paid between corporations and capital gains. Our chairman advises me that I have ten minutes more. I cannot speak very quickly, but I have prepared an agenda which sets out the provisions of the White Paper that apply to dividends paid between Canadian companies and capital gains. I have simply reproduced the paragraph of the White Paper.

Senator Cook: As Part II.

Mr. Gilmour: As Part II, dated February 11. I have time to make one comment, with your permission, which relates to the proposal of grossing up Canadian dividends and ensuring that a corporation pays a minimum of 50 per cent tax, so that the individual shareholder can get the credit of 40 per cent and 10 per cent that we have just been discussing.

Senator Connolly (Ottawa West): You said "minimum". I rather understood it was maximum.

Mr. Gilmour: I do not quite understand you, senator.

Senator Connolly (Ottawa West): Talking about corporate tax, you referred to a minimum of 50 per cent. I rather understood the thrust of the White Paper was to get a maximum of 50 per cent corporation tax.

Mr. Gilmour: That is correct.

The Chairman: Either way you say it, it is 50 per cent?

Mr. Gilmour: Yes.

Senator Connolly (Ottawa West): If it is a maximum, at least they know where they are.

The Chairman: Either way is subject to being increased as well as decreased.

Mr. Gilmour: Perhaps I should withdraw "minimum", or "maximum", and just say 50 per cent.

Senator Cook: For the time being.

Mr. Gilmour: One of the results of this proposed system will be somewhat as follows. Assume there are two tiers of corporations, an operating subsidiary and an operating parent. Assume that the subsidiary has opened up a new business in an area of lesser employment—the old designated areas—so that the subsidiary pays a tax less than 50 per cent because of the three-year tax holiday, or any other subsidies it may get. We can assume the subsidiary pays an effective rate of tax of 40 per cent. When a dividend passes from the subsidiary up to the next tier company, the recipient company has to pay an additional 10 per cent tax on that dividend. So under this new grossing up procedure all the incentive subsidies, all the benefits of incentive legislation to mining companies or oil companies, all the subsidies given by the Department of Industry, Trade and Commerce or the Department of Supply and Services, will be swept away by the tax collector.

The Chairman: Is it fair to say that the principle behind this is that all dividend income somewhere must pay 50 per cent?

Mr. Gilmour: That is correct. In seeking for this ideal, this perfect system, this grossing up system, we find what I imagine are completely unforeseen results. Perhaps they were foreseen, but I do not know.

I should like to leave this one thought with you. When you read these summaries and listen to briefs, you will certainly be hearing that this proposal of grossing up dividends is one of the most serious, if not the most serious, proposal in the White Paper that affects Canadian industry. Some representatives of industry use the word "iniquitous". I am trying to be impartial and saying "important". The basic thought is this. For more years than I can remember we have levied double taxes on corporate profits. We have levied an annual tax when the corpora-

tion earns the profit; then we have levied a tax on the shareholder when the corporation pays a dividend. In the case of what I would call the family corporation, say the closely held corporation, this double tax has been a terrible thing in Canada. Because of the impact of succession duties and the high rates of tax levied on dividend income, people have refused to pay dividends. As we all know, there have been these nasty cases that have reached the Supreme Court. I suppose Con Smythe has been the most outstanding one, in which I think, with respect, he was harshly dealt with as the guinea pig.

For years every one of us has agreed that the closely held corporation should have some system whereby the shareholder of the closely held corporation can take his earnings that have borne a tax of 50 per cent, or possibly 52 per cent, when he sees fit. To do that would remove a major cause of the sale of these family corporations to non-residents. The White Paper proposes just that. It proposes it by adopting the old Victorian system that prevailed in the United Kingdom prior to World War I, and was then abandoned progressively because it would not meet the strain of war finances. The White Paper proposes that the closely held corporation, by grossing up provisions, would be able to distribute its surplus free of tax. For this to be consistent, the paper follows the same grossing up procedure for the widely held or listed companies. At present shareholders of the widely held corporations get a 20 per cent dividend credit. There is nothing significant about 20 per cent. Somebody picked the figure, but it has worked jolly well for many years. In the interest of consistency, the White Paper proposes a grossing up. One of the results of the grossing up procedure is that the tax collector will sweep away all incentives that are granted industry in effect we can do without our Department of Industry, Trade and Commerce and its beneficial program of subsidies.

Therefore, the thought occurs to a simple minded person like myself: why do we need the grossing up for widely held corporations? Nobody has been dissatisfied with the 20 per cent dividend credit. Why go through with all this other nonsense to produce something that will sweep away incentives. This becomes very serious, gentlemen, when I think of the subsidies that are handed out today for industrial and scientific research. As you know, there is an immense sum provided by Canada to encourage Canadian industry to carry on research and improved technology. Vast sums are being spent on that, but our calculations show that these subsidies will be swept away.

Senator Everett: That is true if they are paid in the form of a grant and not in the form of deduction of taxation.

Mr. Gilmour: Yes, senator, most of the subsidies today are offered to you in the form of cash. If you want them as a reduced tax you can have it, but effectively it comes back to a grant that you are given. This grant will, in the normal course of events, fall into the real income of the company, not the taxable income of the corporation. It would not be taxed and therefore this company would be able to pay a dividend to its parent. Such a company would also be entitled to a capital grant and entitled to write off the cost of the capital assets at up to 100 per cent per annum, if it so desires. This capital grant is a cash receipt. While good accounting suggests that you treat it as a reduction of the cost of the asset for tax purposes, your cost is 100 and not the net sum after deductions of the capital grant. There are some very substantial corporations that are in the public eye who receive research grants. These corporations may not pay a penny of tax for many years because of the benefits under the Industrial Research and Development Incentives Act. Consequently, when such a corporation pays a dividend to its parent, the parent has to pay the equivalent of a 50 per cent tax on the earnings of a subsidiary and the benefits are swept away. You could say that this subsidiary does not have to pay a dividend, but if our new system goes on indefinitely that is not the answer.

Gentlemen, I feel that we will be receiving many briefs on that particular subject. I just wish to highlight the effect of these proposals because they may be apparent in the agenda that I have left before you.

The Chairman: You are not able to say, I take it, whether in the calculations that have been made for purposes of the White Paper these factors have been reflected in the figures.

Mr. Gilmour: I think they have been ignored, senator.

Senator Cook: With regard to sweeping away benefits in the case of the small private companies, you are encouraged to get your tax credit—you cannot pay cash—by paying out bonus shares and you keep on doing that and build up your equity, then get knocked in and then by and by you come and die and they take 50 per cent away from you. That is sweeping away the benefit, is it not?

Mr. Gilmour: Yes. Small corporations in the fishing industry receive subsidies. These subsidies will be swept away. We have the glaring case of the old Brazilian Traction company. For entirely different reasons it was forced by currency controls in other lands to pay bits and pieces of stock dividends. The result is that its whole capital issue is in fractions and little pieces of paper and it is difficult, if not impossible, to comfort a proper financing program. Our present law ignores the practical problems and blithely suggests that all companies will be delighted to pay stock dividends.

Senator Everett: I believe, Mr. Gilmour, that it is quite customary for real estate companies to pay dividends even though they show no taxable income on account of depreciation. That is classed as a return of capital and non-taxable in the hands of the recipient of the dividend.

Mr. Gilmour: Senator, it would depend upon the form of the dividend. The basic rule is that any distribution made by a company to the shareholders, while it is a going concern, is a taxable dividend to the shareholder, irrespective of the source of the dividend. If you have a real estate company with lots of capital cost allowances you would claim a deduction of the capital cost allowances so that you would have no accumulative undistributed income on hand. Then you would either reduce your capital or pay a stock dividend in a redeemable share which is promptly redeemed. If section 138A did not get you, you would have a distribution of capital.

Senator Everett: Under the proposed rules there would be creditable tax and therefore the whole dividend would be taxable in the hands of the shareholder.

Mr. Gilmour: I believe that is correct.

Senator Everett: It can be classed as returns of capital. Under the present system, capital that is usually tax free will by virtue of this became taxable income.

Mr. Gilmour: I believe that is correct.

The Chairman: Have we finished that part, Mr. Gilmour? The meeting is now adjourned. We are making a summary now as to when we may expect to have briefs coming in. We are getting closer to that time now. Whether we sit next week or not depends on whether the Senate is sitting next week and I do not know that yet. We should have two briefs available for next week if we have a sitting and I shall let you know.

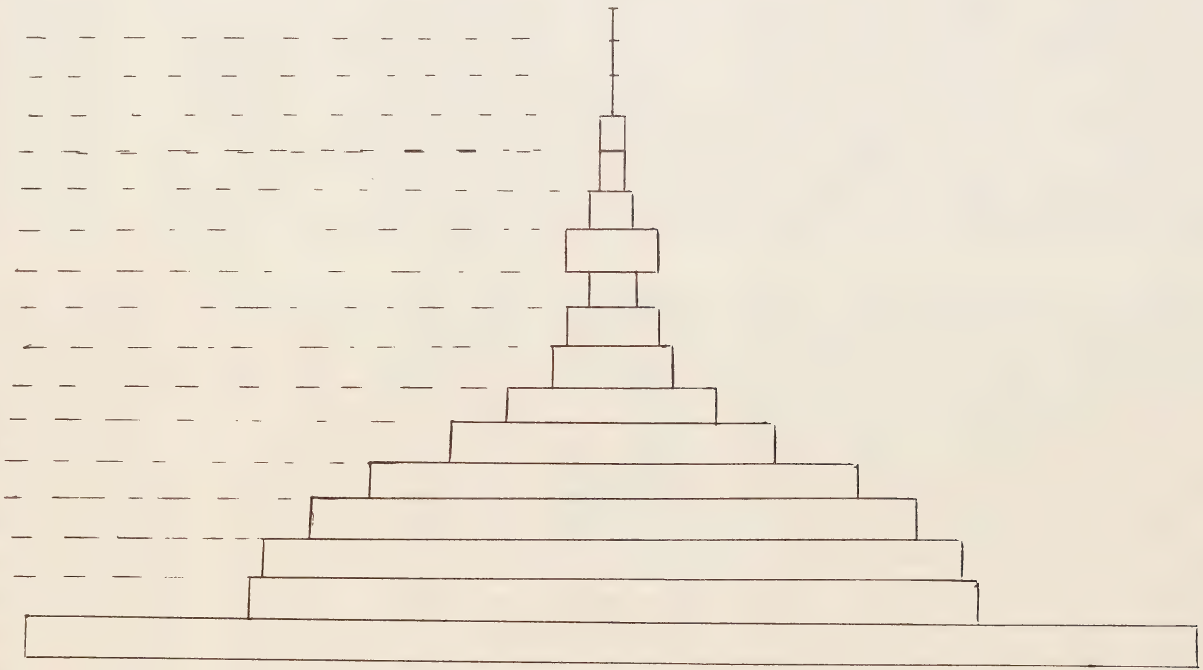
The committee adjourned.

APPENDIX A

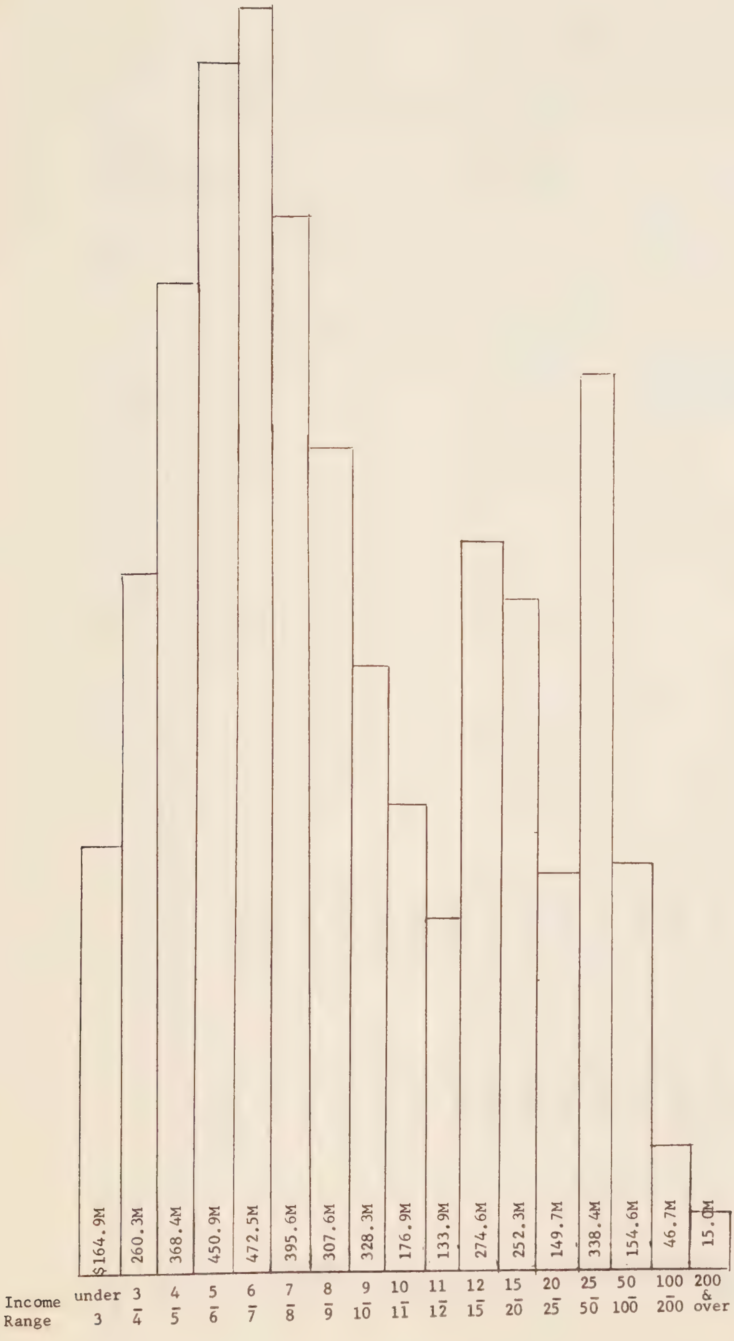
Addenda to Special Study No. 3 (See Issue No. 7, February 4, 1970)

Number of Taxable Returns by Income Classes
- 1967 -

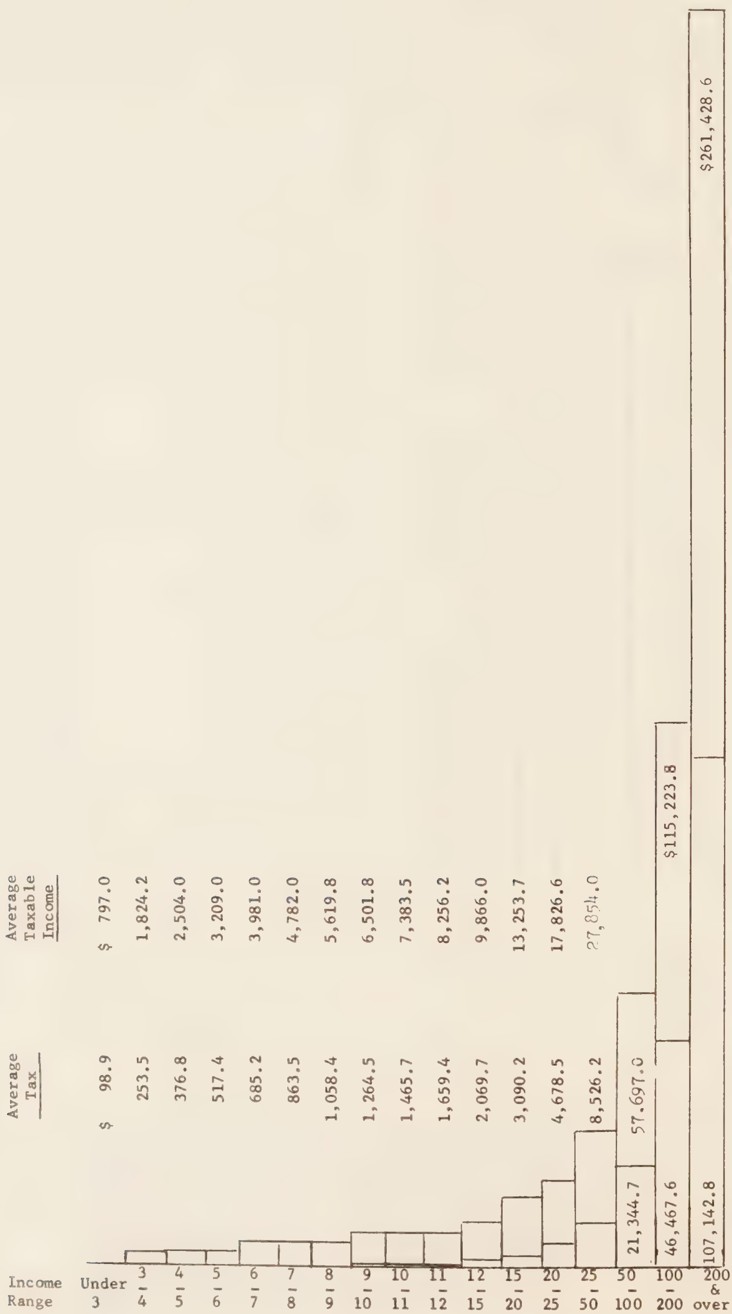
Income Class '000	No. of Taxpayers in Class
200 & over	140
100 - 200	1,005
50 - 100	7,243
25 - 50	39,689
20 - 25	31,997
15 - 20	81,645
12 - 15	132,670
11 - 12	80,690
10 - 11	120,688
9 - 10	180,542
8 - 9	290,614
7 - 8	458,090
6 - 7	689,497
5 - 6	871,320
4 - 5	977,456
3 - 4	1,026,477
under 3	1,665,920
	6,655,683



Federal Individual Income Taxes, Old Age Security Tax and Provincial Income Taxes Collected for Agreeing Provinces (excluding Quebec) by Income Classes
- 1967 -



Average Taxable Income of Individuals by Income Classes
and
Average Individual Federal Income Taxes, Old Age Security Taxes and
Provincial Income Taxes collected for Agreeing Provinces (Excluding Quebec)
- 1967 -



MARITAL STATUS

Claimed by the 6,655,683 Taxpayers Paying Income Taxes

in 1967

	Individuals	
Single - No dependents	3,373,142	
- With one or more dependents	641,524	4,014,666
Married - No dependents	748,950	
- With 1 dependent	511,228	
- 2 dependents	577,312	
- 3 dependents	400,308	
- 4 dependents	220,342	
- 5 or more dependents	182,877	2,641,017
Total individuals		6,655,683

APPENDIX B

TAXATION OF DIVIDENDS

A - Proposal

1.39 The government proposes to alter the method of taxing corporations by establishing a single rate of corporation tax and providing a system of credits to shareholders for corporate taxes paid. An important distinction would be made between private, closely-held corporations and public, widely-held corporations.

1.40 For closely-held corporations, which are usually smaller businesses managed by the shareholders, the tax should be related as closely as possible to rates paid by individual shareholders. There is usually a close identity between the shareholders and the corporation. These corporations usually compete in markets with unincorporated businesses subject only to personal income tax. Under the proposed plan the federal income tax paid by such corporations would be treated as a prepayment of the personal income tax on behalf of individual resident shareholders. Under certain conditions the corporation could elect to be taxed as a partnership of its shareholders. In other cases the shareholders would pay tax on a sum that includes their dividends plus a related amount of corporate tax already paid; and they would then claim credit for the corporate tax paid, and qualify for a refund if their own rates are lower than the corporate rate.

1.41 The government believes that this is a fairer way of taxing the income of Canadians which flows through corporations than the existing system with its lower rate of corporate tax on $35,000 of profits annually. It proposes to remove this lower rate gradually over a period of five years. Thereafter, the benefits of low rates of tax would go to shareholders with small incomes rather than to corporations with small incomes.

1.42 Widely-held corporations are usually larger businesses where the link between shareholders and management is tenuous. Such corporations are themselves important economic entities. Their products or services are usually sold in competition with other large corporations, where prices yield an adequate return after paying corporate tax. One half the corporate income tax paid by such corporations would be regarded as a prepayment of individual tax for individual Canadian resident shareholders, but the other half would not be linked in this way. Shareholders receiving dividends from profits taxed under the new plan would be liable for tax on the dividend plus an amount of "creditable tax" equal to half the dividend and would be given credit for that amount of tax. This system would be roughly equivalent to the present dividend tax credit for taxpayers in the 50-per-cent tax bracket and would be more favorable for those in lower tax brackets. It would thus provide a powerful incentive for investment by Canadians in Canadian corporations.

1.43 Examples of this plan are set out in paragraphs *4.25* and *4.37*.

1.44 This new system would:

- offer a substantial inducement for Canadians to invest in Canadian business;
- when combined with the proposed method of taxing capital gains, make possible a fair and fully effective but economically tolerable tax system;
- prevent surplus stripping and most other tax avoidance devices;
- be fairer in its treatment of lower-income shareholders than the present dividend tax credit and preferred low rate of tax on the first $35,000 of corporate income.

4.19 The government's proposal is to create one set of rules for the closely-held corporation—the incorporated proprietorship or partnership—and another set of rules for the widely-held, public corporation. This distinction reflects the difference in the relationship between the two types of corporations and their respective shareholders. It also reflects the fact that, by and large, the closely-held corporation competes with proprietorships, partnerships and of course with other closely-held corporations, while the public corporation competes with other public corporations, both Canadian and foreign.

B – Estimates

8.10 It has been necessary to estimate the proportion of the dividends received, and which would be received, by Canadian-resident individuals and by Canadian closely-held corporations, respectively, from closely-held Canadian corporations and from widely-held Canadian corporations. Assumptions have also been made about corporate behavior in the payment of dividends under the tax arrangements proposed for widely-held and closely-held Canadian corporations. It has been assumed that, once the system is fully effective, closely-held corporations effectively controlled in Canada would pay out the whole of their profits in order that shareholders could take full advantage of the credit for corporate tax. Most of the additional payout is expected to be in the form of stock dividends. During the first four years there would be a tendency on the part of closely-held corporations controlled by high-income Canadians to delay this increased payout so that the marginal rates would have decreased as far as possible towards 50 per cent. All in all, we would expect only a modest increase in the total of cash and stock dividends paid by closely-held corporations in the first year of the new system, but a substantial increase in the fifth and subsequent years. We have assumed that widely-held corporations would not increase their dividends as a result of the tax proposals.

8.22 The final item to be taken into account is the proposed change from the dividend tax credits to a new system for giving shareholders credit for part or all of the Canadian taxes paid by their corporations. Our expectations concerning the dividend policies of corporations were noted in paragraph *8.10*. On the basis of those expectations it is estimated that this change would have cost $140 million in personal tax revenue in 1969 if that had been the first year of the system and $230 million if it had been the fifth year of the system. The cost of this change must of course be considered together with the increased revenue expected from the removal of the low rate of corporation tax and from the taxation of dividends from widely-held Canadian corporations when received by closely-held corporations. Together these two corporate changes would have produced $155 million in tax revenue in 1969 if that had been the first year of the proposed system and $450 million if it had been the fifth.

8.23 The $140 million is the net of three amounts. First, the estimated credit to be given to shareholders would reduce revenues. Offsetting this there would be additional revenue from the tax collected on that credit, and on the increased dividends it is expected that the proposed system would prompt. Finally the present 20-per-cent dividend tax credit would be cancelled: this would reduce the net cost of the proposed system. The following schedule illustrates the interaction of these three factors: the provincial figures are based upon a provincial tax at 28 per cent of federal tax. The figures are in millions of dollars:

	Combined Federal and Provincial	*Provincial Share*	
Tax on additional dividends and on the taxable credit itself	$ 210	(28/128)	$ 45.9
Dividend tax credit cancelled	130	(28/128)	28.4
	340		74.3
Credit for corporation tax	480	(1/5)	96.0
Net cost	$ 140		$ 21.7

C - Distributions of Dividends by Closely-Held Corporations

4.24 In the case of those corporations which are not to be treated as partnerships, parity with the shareholders of partnership corporations would be achieved in two steps. There would be a tax of 50 per cent on the taxable income of the corporation. However, when the net profits are distributed to the shareholders, credit would be given for the full amount of the tax paid by the corporation on those profits.

4.25 An example may help to explain how this system would work. A closely-held corporation with profits of $20,000 would pay a tax of $10,000, leaving $10,000 to be distributed to the shareholders. When the corporation pays the next $10,000 in dividends, it would instruct the shareholders to report $20,000 as their income for tax purposes (the before-tax profit of the corporation) and to claim credit for the $10,000 of tax paid by the corporation. A shareholder who receives a dividend of $100 would therefore report $200 as his income from the corporation and would show on his return that $100 tax had been paid by the corporation. If his marginal tax rate is 40 per cent, the tax on the dividend would be $80 and he would be entitled to a refund from the government of the extra $20. In this way the ultimate tax on his share of the profits of the corporation would be the same as if he had received the $200 directly.

4.26 This procedure of giving credit to the shareholder for taxes paid by the corporation would be applied both to cash dividends and to stock dividends, so that the process should not by itself force private corporations to pay out in cash a higher proportion of their profits than they would under the present system. In the case of a stock dividend, the shareholder would of course not have received any cash from the corporation with which to pay his tax. However, the credit he receives for the tax paid by the corporation would cover his liability on the dividend unless his marginal tax rate exceeds 50 per cent. Therefore the system would not result in taxpayers being forced to pay tax at a time when they lack means to satisfy the tax liability.

4.27 For the shareholder to receive credit for tax paid by a corporation, the corporation would have to pay the appropriate dividends—either cash or stock—within a limited period of time. It is proposed that tax paid with respect to a given taxation year should be creditable only if it is passed through to the shareholders within 2½ years from the end of the corporation's taxation year. This is necessary in order to limit the amount of outstanding claims against the government: if corporations accumulated creditable tax for 10 or 15 years, large dividends at the end of that time could seriously affect government revenues in the year of distribution. Further, the rule would limit the amount of creditable tax in any given corporation at any given time and so reduce the temptation to taxpayers who cannot make use of creditable tax to "sell" it to taxpayers who can make use of it.

4.28 The government believes this is a fairer way of dealing with the income of Canadians flowing through closely-held corporations. In effect, the present system gives an arbitrary concession to small corporations. The proposed system would graduate the tax according to the circumstances of the shareholder. Therefore the benefit would go to shareholders with small incomes rather than to corporations with small incomes.

4.32 Taken together these proposals concerning closely-held corporations should provide a tax system with the same effect on business carried out through such a corporation as on business carried on through a proprietorship. It should also collect the same tax on the investment income of a Canadian individual whether he holds his investments directly, or whether he holds them through a personal holding corporation.

4.33 Meanwhile gains realized on the sale of shares in closely-held corporations would be taxed as ordinary income, and losses suffered on the sale of such shares would be deductible from other income for tax purposes. When coupled with the system of full integration, this would mean that the tax effects would be the same whether an individual causes his corporation to sell its assets to a prospective purchaser or chooses to sell his shares to that purchaser, thereby giving the purchaser indirect control of the assets.

D - Tax on Recaptured Depreciation

4.79 To secure tax on the recapturable depreciation, it is proposed that part of the tax paid by closely-held corporations be treated as non-creditable until non-creditable tax has been collected on the amount that would have been taxable under the present system. This would of course not accomplish the objective with respect to corporations that are to be treated as partnerships. Shareholders of such corporations would have to elect to value their shares in the same manner as a proprietor or partner is to value his business assets—at values that would leave inventory profits and recapturable depreciation taxable.

E - Distribution of Dividends by Widely-Held Corporations

1.42 Widely-held corporations are usually larger businesses where the link between shareholders and management is tenuous. Such corporations are themselves important economic entities. Their products or services are usually sold in competition with other large corporations, where prices yield an adequate return after paying corporate tax. One half the corporate income tax paid by such corporations would be regarded as a prepayment of individual tax for individual Canadian resident shareholders, but the other half would not be linked in this way. Shareholders receiving dividends from profits taxed under the new plan would be liable for tax on the dividend plus an amount of "creditable tax" equal to half the dividend and would be given credit for that amount of tax. This system would be roughly equivalent to the present dividend tax credit for taxpayers in the 50-per-cent tax bracket and would be more favorable for those in lower tax brackets. It would thus provide a powerful incentive for investment by Canadians in Canadian corporations.

4.34 By and large, a Canadian widely-held public corporation competes with other public corporations. In this league it is natural for the competition to bear a corporation income tax and we consider it likely that some level of corporation tax is passed on to customers in the price which the corporations charge for their goods and services.

4.35 At present United States corporations bear tax at 52.8 per cent and United Kingdom corporations at 45 per cent. Against this background a Canadian corporation tax of 50 per cent seems reasonable and competitive. For this reason the government does not propose to give Canadian shareholders of such corporations full credit for the corporation tax paid by those corporations.

4.36 However, the government does want to reform the dividend tax credit. It proposes to replace the existing credit with a system giving Canadian shareholders credit for one-half the Canadian corporation tax paid by the corporation on the profits from which the dividend is paid.

4.37 Again, an example may help to explain how the system would work. A Canadian public corporation with profits of $1,000,000 would pay a tax of $500,000, leaving $500,000 available for distribution to the shareholders. If it pays the $500,000 out in dividends, it would instruct the shareholders to report $750,000 as their income for tax purposes and to claim credit for $250,000 of the $500,000 of corporate tax paid by the corporation. A shareholder who receives a dividend of $100 would therefore report $150 as the income from the corporation and would show on his return that $50 tax had been paid by the corporation, $40 federal and $10 provincial. If his marginal tax rate is 40 per cent, the tax on the dividend would be $60 and he would owe the governments $10. If his marginal tax rate is less than one-third he would be entitled to a refund. As in the case of closely-held corporations, this procedure would be applied both to cash dividends and to stock dividends so that the process should not by itself force corporations to pay out in cash a higher porportion of their profits than they would under the present system. Also, as in the case of closely-held corporations, the credit would only be given if the corporation declares these dividends within the time limits prescribed.

4.38 The government believes this way of providing an incentive to Canadians to purchase shares in Canadian corporations is fairer than the dividend tax credit. It would give all Canadian individuals credit for the same amount of corporate tax on any given dividend.

4.39 It would also mean that credit is given only for taxes actually paid to Canada so that the incentive would be limited to a forgiveness of tax and would not involve a net payment from the Canadian treasury.

4.40 While credit would not be given for foreign corporation taxes paid, it is proposed that corporations receiving income from other countries be enabled to pass through to their shareholders credit for 15 percentage points of withholding tax levied by those foreign countries on the income received. This would provide neutrality between those taxpayers who receive foreign investment income directly and those other taxpayers who receive it through a Canadian corporation. It would also, to a substantial extent, offset the loss of the dividend tax credit for shareholders of those corporations. This provision is explained in more detail in Chapter 6.

4.41 This system of partial credit also produces a rough balance when combined with the proposal that gains or losses on the sale of shares in Canadian widely-held corporations be taken into account only to the extent of 50 per cent in computing taxable income. This balance is not precise. It is almost exact in the case of upper-income taxpayers, those most likely to be able to arrange their affairs to receive their income in the form that reduces taxes to a minimum. It is less balanced in the case of taxpayers in lower rate brackets. They would be better off to receive their income in dividends than in the form of capital gains. This probably coincides with their natural inclination to buy into well-established Canadian corporations where their investment is less at risk.

4.42 As mentioned above and in Chapter 3, the government proposes that half of the gain on the disposal of a share of a Canadian public corporation be taken into account in computing taxable income. This lower rate of tax on the gain would complement the partial credit given for corporate tax and provide the other half of the government's incentive to Canadians to invest in Canadian corporations. To forestall a fairly straightforward tax-avoidance technique, it would be necessary to grant deduction for only half of the loss on the sale of such a share.

4.43 These proposals obviously put considerable importance on the distinction to be drawn between closely-held Canadian corporations and widely-held Canadian corporations. The rules proposed for defining a widely-held corporation are as follows:

(1) All corporations with shares listed on a prescribed Canadian stock exchange on the day the White Paper is published would be deemed to be widely-held corporations.

(2) All corporations which subsequently list their shares on these exchanges would become widely-held corporations on the day on which their shares are so listed.

(3) Corporations which can meet specified tests concerning the number of shareholders and the number of shares held by those shareholders could elect to be classified as widely-held corporations.

(4) The Minister of National Revenue would have the power to designate other corporations as widely-held corporations if they meet certain tests relating to number of shareholders, dispersal of shares and public trading in shares. (In practice this would mean that most corporations with shares traded "over the counter" would be classified as widely-held corporations.)

(5) Once a corporation is classified as a widely-held corporation it would always remain a widely-held corporation.

Only corporations incorporated in Canada would be eligible to be treated as Canadian widely-held corporations.

4.44 From the time a corporation becomes a widely-held corporation shareholders would receive credit for only half the tax paid by the corporation. Any creditable tax on hand at the time of transition would effectively be cut in half.

4.45 Proceeds from the sale of a share of such a corporation after it becomes a widely-held corporation would be taken into income for tax purposes to the extent of 50 per cent, even though part of the increase in value may well have occurred while the corporation was a closely-held corporation. This provision reflects the expectation that closely-held corporations would distribute—either by cash dividend or stock dividend—almost all of their profits to their shareholders, and that the accruing capital gain, if any, on such shares would therefore relate almost entirely to the expectation that the corporation would be able to earn greater profits in future. Because the shareholders would receive credit for only half of the corporation tax paid on these future profits, it is reasonable that the government collect tax only at half rates on the sale of those future profits.

F - Inter-Company Dividends

(i) Where shareholder is a Closely-held Corporation:

4.55 The government proposes to restrict the credit to shareholders of Canadian corporations by reference to the Canadian corporate tax actually paid by their corporations. To do this the government must have a more exact method of passing credit for Canadian corporate tax through a chain of corporations. Moreover, the decision to tax capital gains on disposal of shares requires that a more precise method be found for giving credit for corporate tax. Otherwise corporate shareholders could choose to receive tax-free dividends and then to sell their shares, thereby avoiding entirely the tax which would otherwise have been levied on the gain realized on the sale of their shares.

4.56 A closely-held Canadian corporation would be treated in exactly the same manner as would an individual shareholder in receiving credit for corporate tax. Specifically, it would take into its taxable income both the dividend and the taxable credit, and would claim the creditable tax as a deduction against the corporate tax which it would otherwise pay. The following table illustrates how this system would work.

Dividend received:		
From another closely-held Canadian corporation	$100	
From a widely-held Canadian corporation		$100
Plus taxable credit	100	50
Taxable amount	200	150
Gross tax	100	75
Less credit	100	50
Net tax	0	25
Amount available for distribution to its shareholders (dividend minus net tax)	100	75
Creditable tax available (gross tax amount)	$100	$ 75

(ii) Where shareholder is a Widely-held Corporation receiving dividends from a Closely-held Corporation:

4.57 A widely-held Canadian corporation receiving a dividend from a closely-held Canadian corporation would be taxed on the dividend in the same way that it is taxed on other income. Specifically, the corporation receiving a dividend of $100 from a closely-held Canadian corporation would take into its income for tax purposes $200 and claim as a deduction from the corporate tax it would otherwise pay the $100 corporation tax paid by the first corporation. In effect the dividend would have been received tax-free in this situation. However, if the corporation that pays the dividend has not paid sufficient corporation tax to Canadian governments to cover the dividend, the receiving corporation would have some net tax to pay.

4.58 When the receiving corporation pays a dividend to its shareholders it would instruct them to add to the dividend for purposes of the tax calculation only half of the corporation tax levied on it. The schedule set out below illustrates this procedure. The effect is that shareholders of Canadian public corporations receive credit for half, and only for half, of the corporation tax paid on the profits from which their corporation pays its dividends. This is true whether the profits are earned in a subsidiary corporation or in the public corporation itself.

Dividend received	$100	$100
Plus taxable credit:		
Assuming the payor corporation had enough creditable tax	100	
Assuming that it did not have enough, say 4/5ths		80
Taxable amount	200	180
Gross tax	100	90
Less credit	100	80
Net tax	0	10
Amount available for distribution to its shareholders (dividend minus net tax)	100	90
Creditable tax available (half of gross tax amount)	$ 50	$ 45

(iii) Where shareholder is a Canadian public company receiving dividends from another Canadian public company:

4.59 Special rules are needed to cover the case of a public corporation which receives a dividend from another public corporation. If the dividend were taxable at normal corporate rates, the effect would be to collect more corporate tax in those instances where there are intercorporate holdings than in those instances where the individual shareholder holds his share in the operating corporation in his own name. To overcome this shortcoming it is proposed that a special tax rate be applied to the dividends received by Canadian public corporations from other Canadian public corporations. The rate would be 33⅓ per cent so that this type of intercorporate dividend would be tax-free provided the corporation paying the dividend had paid sufficient Canadian corporate tax to cover the dividend. This special rate would also be applied to capital gains realized by one Canadian public corporation on the sale of shares in another Canadian public corporation. Finally, the loss suffered by one Canadian public corporation on the sale of a share in another Canadian public corporation would reduce tax only at this special rate. The effect of this rate on dividends passing through an intercorporate chain is illustrated in the following schedule:

	Corporate Chain	*Direct Ownership*
Dividend paid by public corporation No. 1	$100	$100
Public corporation No. 2		
Dividend received	100	
Plus taxable credit	50	
Taxable amount	150	
Gross tax, at 33⅓%	50	
Less credit	50	
Net tax	0	
Amount available for distribution	100	
Creditable tax (gross tax amount)	$ 50	
Individual shareholder		
Dividend received	$100	$100
Taxable credit	$ 50	$ 50

G – Where Shareholder is a Pension Fund or Mutual Fund

4.60 The government does not propose a refund to pension plans and other tax-free entities of the corporate tax paid by the corporations from which they receive their dividends. It considers that tax-free status of the investment income of the pension plan, including capital gains, is sufficient tax concession to these entities.

Shares held by Mutual Funds

4.61 Open-end mutual funds and most closed-end mutual funds would be widely-held corporations under the definitions proposed earlier in this chapter. As a result shareholders would receive the dividends that flow through the mutual fund subject to the same tax as if they had received the dividends directly. There is one exception to this, in the case of dividends from a closely-held corporation that are routed through a mutual fund. In this instance the government feels it appropriate to levy the same taxes on this portion of the corporate income as if the earnings had been in a public corporation. The relationship of the shareholder of the mutual fund to his corporation is much the same as that of shareholders of other public corporations to their corporations.

4.62 A special rule would, however, be required for mutual funds. This type of corporation must be able to put its shareholders in the same position as if they themselves had realized their proportion of the capital gains of the mutual fund arising on the sale of shares in public Canadian corporations. In the absence of a special provision mutual fund shareholders would pay tax on the full amount of such gains when they were distributed to them, whereas tax should be applied only to half of the gain. Consequently this type of corporation would be enabled to make special distributions to its shareholders which would be treated as though they were a capital gain on the sale of a Canadian public corporation.

TAXATION OF CAPITAL GAINS AS INCOME

A – Proposal

1.28 The government has decided to include capital gains and a number of other benefits in income subject to tax. Reviews of this subject by the royal commission and the government led to the conclusion that this is essential in order to be fair between those receiving such gains and others deriving their incomes from other sources. Moreover, the taxation of gains is essential to block loopholes effectively. The economic effects of taxing gains have been appraised and are considered unlikely to interfere significantly with incentives to save and invest in Canada.

1.29 Those who make substantial capital gains in the stock market or in real estate increase their ability to spend money just as those who earn wages or derive an income from carrying on business. Interest payments are already fully taxed. Capital gains are now widely sought as an objective in investment. Indeed the freedom of capital gains from tax is distorting the investment of savings under present circumstances.

1.30 In general we propose to include capital gains fully in income for most classes of assets whenever they are realized by the sale of such assets, and to allow realized capital losses to be deducted from income. Certain exemptions would be permitted for taxpayers' homes and for articles of personal property. Special rules would apply to the marketable shares of widely-held Canadian companies. On such shares accrued gains would be taxed every five years and accrued losses allowed as deductions at such time. Only half the gain or loss on such shares would be taken into taxable income in recognition that the corporation income tax paid by such companies is only partially credited for personal income tax. This is explained in Chapter 3.

3.13 The government proposes that capital gains be subjected to a progressive tax as part of the general income tax system. Depending on the nature of the asset, all or part of the gain would be included in income and taxed at the taxpayer's marginal rate. Similarly, all or part of capital losses suffered by a taxpayer would be deductible from taxable income and so save the taxpayer tax at his marginal rate. It would be necessary to prohibit the deduction of losses which are in fact the result of personal consumption: for example, the loss on a sale of the family car.

B – Estimates

1.31 Once capital gains are included in taxable income, the portion of the total income of the wealthy that is brought to tax would be dramatically increased. The tax system would be significantly more progressive even without the ostentatiously high rates now in use. It is proposed that the marginal rates in excess of 50 per cent be reduced to the neighborhood of 50 per cent in four instalments as the capital gains subject to tax increase. As the estimates in Chapter 8 indicate, based on 1969 incomes by the fifth year of the new system the inclusion of capital gains in taxable income should add about $345 million to personal income taxes, while the reduction of the top rates to 50 per cent on other income should cost about $40 million.

3.14 If capital gains are included in income for tax purposes, the portion of the total income of the well-to-do that is brought to tax would be dramatically increased. As previously mentioned, the income tax system would become significantly more progressive, and we would no longer need the very high rates of tax in order to have a fair system.

3.55 The lack of Canadian experience with a capital gains tax system means that it is impossible to develop precise estimates of possible yields. However, we anticipate that after it has "matured", the proposed system would produce several hundreds of millions of dollars annually. The United States tax on capital gains raises between 5½ per cent and 7 per cent of the total United States personal income tax. While there are significant differences between the United States system and these proposals, we estimate that the taxation of capital gains could ultimately produce more than 5 per cent of total Canadian personal income tax: 5 per cent of the estimated current yield of the income tax is approximately $390 million.

3.56 However, the yield from the tax would build up only gradually. For one thing, gains subject to tax would be limited to those gains that accrue following valuation day. In addition, since most gains and losses would be taken into account only when realized during the first four to eight years, there would be a natural tendency for people to take their losses earlier than usual in order to obtain the tax saving, and realize their gains later than usual in order to postpone the tax liability. All in all, we estimate that the period of build-up would take between seven and ten years.

8.9 To calculate the effects of taxing capital gains, the share gains and losses that would be taken into account have been estimated on the basis of a study made for the Royal Commission on Taxation of price behavior of Canadian stocks in relation to dividends. To this have been added figures for other gains and losses that might be expected on the basis of the relationships in the United States between gains on corporation shares and other gains. This latter estimate has been adjusted for differences between the U.S. tax structure and that proposed for Canada. These estimated gains have been distributed among the various income groups in the sample in order to calculate changes in tax yields. Estimates of this dispersion have been based on a detailed study of the United States figures which were published for 1962, taking into account such differences between the U.S. situation and the Canadian situation as appeared relevant, and the fact that 1962 was an unusual year in respect of capital gains and losses.

8.12 Several of the measures proposed would have an increasing effect as time goes on. The main instance of this is capital gains. The elimination from tax of any gains or losses arising before the valuation date would mean a gradual build-up of both taxable gains and losses. To reflect the gradual increase in revenues an estimate has therefore been made for the fifth year in which the new system is in effect. This estimate assumes the 1969 income base so that the difference reflects changes in the effectiveness of the tax system rather than economic changes. The fifth year marks the end of many of the transitional measures. The dual rate of corporation tax would be fully eliminated. The taxation of accrued capital gains on the shares of widely-held Canadian corporations would be in effect. The personal income tax rates would be fully adjusted to the new schedule. The revised international tax treaties should be in effect. Averaging would be fully in effect.

8.20 In the first year of the revised system, the inclusion of realized capital gains in income and the deduction of capital losses are estimated to produce net revenue of $60 million. This does not reflect an estimate of actual market behavior in 1969 but rather the longer-term relationship established in earlier years. It must be emphasized that this item cannot be forecast accurately, because it depends on changes in market values after the valuation date to be designated and on the behavior of Canadians confronted with a wholly new tax situation. If 1969 were the fifth year of the proposed system, the net tax revenue from realized gains and losses is estimated at $245 million. In addition, there is an amount of $100 million in respect of net gains arising through the periodic revaluation of the shares of widely-held Canadian corporations. In the fifth year, approximately one-fifth of the taxpayers who hold shares would follow this process.

8.27 Corporations, like individuals, would have taxable capital gains substantially larger than their capital losses. These are in addition to those business capital gains which have been taxable under the present law because they are part of the trading profits of the business, or represent the "recapture" of capital cost allowances previously claimed but recovered. The net revenue derived from these newly taxable gains is estimated at $35 million in the first year of the system and $100 million in the fifth.

C - Valuation Date

3.15 The government does not propose to tax gains that arise before the new system is introduced unless those gains would have been taxed under the present system. Consequently, the general rule would be that taxpayers could deduct from the proceeds of sale of assets the value of those assets on "valuation day". Consider the case of the taxpayer who bought a block of shares in 1964 for $1,500 which today is worth $2,500. If the new system were to go into effect with today as valuation day, and if the taxpayer were to sell his shares a year from now for $2,600, his taxable gain would be only $100. If he were to sell them for $2,100, he would have a loss for tax purposes of $400.

3.16 The natural and ordinary thing to do would be to proclaim that valuation day is to be the day on which the new system is to begin. However, if that were done, the pressure on market prices on that day could be tremendous, and the opportunities for price-fixing too great. To avoid these consequences, the government proposes to choose a day close to the beginning of the system and to announce that evening that it was valuation day.

D – Averaging of Income

3.17 Once the tax on capital gains had been part of the system for a few years, taxpayers would begin to report gains that had accrued over several years. In the absence of special provisions, this could result in a much larger than usual income in that year and could make the taxpayer liable for a marginal rate of tax considerably higher than the rates that would have applied had his income been spread over the years during which the gain accrued. The averaging provisions described in Chapter 2 would overcome this effect.

E – Taxation of Gains Realized on Sale of Principal Residence

3.19 Generally, capital gains on the sale of homes would not be taxed. This would be accomplished by providing that when a taxpayer sells his principal residence only the profit in excess of $1,000 per year of occupancy would be taxed, and by granting the "rollover" discussed in the next paragraph. Both of these provisions would of course apply on the sale of a farm with farmhouse that has been a principal residence. The $1,000 per year exemption would also compensate for the fact that losses on the sale of a taxpayer's residence other than a farmhouse sold with the farm, would not be deductible from income for tax purposes. The government believes it would be virtually impossible to distinguish between losses which arise from changes in the real estate market and losses which arise from the aging of the house and normal wear and tear. Naturally in calculating his profit the taxpayer would be able to take into account the cost of the improvements he has made. If he does not bother to keep records, he would be allowed instead a home improvement allowance of $150 per year of occupancy.

3.20 In addition to the exemption, the government proposes that a taxpayer who moves from one area to another within Canada in connection with a change of job should be entitled to treat the sale of his home and the purchase of a home in the new area as a non-taxable transaction. In technical terms, he would be granted a "rollover". If the taxpayer spends the proceeds of the sale of one house on the purchase of another within a year from the date of the sale, any profit that would be taxable on the sale of the old house (that is, after deducting the exemption) would be deducted from the cost to him of the new house. In this way, the profit would increase his gain on the ultimate sale of his new house (or reduce his loss), and tax would not be due before that time.

3.21 A taxpayer who has two homes could only claim the exemption or the rollover with respect to one of them. He would have to declare which is his principal residence. Similarly, a husband and wife would have to choose one principal residence for both of them, unless they are separated pursuant to a divorce, judicial separation or written separation agreement.

F – Taxation of Gains Realized on Sale of Assets, other than a Principal Residence

3.22 This category would include such things as cars, boats, stamp collections, paintings, sculptures and cottages, etc. It might, therefore, include assets that the owner hopes can be resold later for more than they cost after he has had the use or enjoyment of them for a time.

3.23 If all profits on this type of asset were to be taxable, Canadians would have to become a nation of bookkeepers. The government proposes a rule which should have the effect of significantly reducing this record-keeping. When a taxpayer sells such an asset, he would not be taxed unless the proceeds exceed $500. If the proceeds do exceed $500 he could deduct from those proceeds either his cost or $500 whichever is the greater. This would have the result that Canadians need keep a record of the purchase of items of this type of personal property only if the cost of the item exceeds $500. To protect the revenue it would be necessary to provide that a series of sales of items of a set would be treated as one sale in applying the $500 limit.

3.24 As a companion to the $500 rule on gains, losses would not be deductible unless the item sold cost more than $500. If an asset did cost more than $500, the deductible loss would be computed by deducting from the cost either the proceeds or $500, whichever is greater.

3.25 Because this category of assets involves items bought for personal use or enjoyment, it would also be necessary to impose some over-all limitations on the deductibility of losses. Otherwise, some taxpayers could reduce their taxable income by deducting personal expenses. Therefore, the government proposes that if an item in this category is of the nature that it depreciates through use, a loss on the sale of this item would not be deductible. Examples of this type of asset would include furniture, cars, boats and cottages held for personal use.

3.26 A second type of asset within the general category does not decrease in value through use. In this group one would include paintings, sculptures, jewellery and coin and stamp collections. However, in order to recognize the personal nature of these assets and of the losses resulting on their sale, the government proposes that such losses be deducted only from gains realized on the sale of the same type of asset. If the taxpayer does not have enough taxable gains of this nature in the same year to absorb the deductible loss, the balance could be offset against such gains either in the immediately preceding year or in the year immediately following.

3.27 These rules would of course not apply to persons who are in the business of buying and selling this type of asset. Dealers would continue to be taxable on their profits and entitled to deduct their losses within the limits which apply to business losses. There would be cases where it would be difficult to determine when a hobby has become a business. This difficulty exists at present and has not been particularly acute with respect to this type of asset.

G – Taxation of Gains Realized on Sale of Investments in Bonds, Mortgages and Rental Real Estate

3.28 This category would involve investments such as bonds, mortgages, agreements for sale, and rental real estate. It is proposed that profits from the sale of these assets be brought fully into taxable income and that losses on the sale of assets of this type be fully deductible in computing taxable income. Taxpayers who obtain bonds, mortgages and agreements for sale at a discount with a low coupon yield would be in the same position as taxpayers who buy at par with a higher coupon yield.

3.29 The general rule that taxpayers would not be taxed on more than the increase in value of such investments after valuation day would apply to these assets. Further, if bonds, mortgages and agreements for sale that a taxpayer now holds are worth less on valuation day than the taxpayer's cost—or his "amortized" cost if he bought it at a discount—the recovery of cost or amortized cost would not be treated as income. For example, if a taxpayer bought a 6-per-cent bond at $100, and that bond is quoted on the market on valuation day at $85, there would not be tax on the redemption or sale of the bond unless the taxpayer receives more than $100. Another taxpayer who purchased a bond of that issue in the market for $80 would be taxed on redemption or sale if he receives more than the $85, unless writing the $20 discount off over the remaining term of the bond would have increased his "amortized cost" to more than $85.

3.30 The government does not wish to force Canadians to compute the "amortized cost" of their present portfolio of bonds where the original discounts were small. Therefore, if a taxpayer had purchased an issue for 95 per cent or more of its face value, he would be exempt from tax on sale or redemption, unless the proceeds exceed the face value of the bond. These transitional arrangements would, of course, only apply to taxpayers who are not at present taxable on the realization of discounts. Bond traders, chartered banks, life insurance companies and others who are now taxable on the realization of discounts would continue to be so.

Press release on Benson statement.

H – Revaluation of Shares of Widely-Held Corporations Every Five Years

3.32 The final category of assets for special mention consists of shares in widely-held Canadian companies. Again, this phrase is defined in Chapter 4, but it would include listed Canadian companies and Canadian companies whose shares are traded over the counter.

3.33 Taxpayers other than widely-held Canadian corporations would include only one-half of their gains on the sale of these shares in taxable income and deduct only one-half of their losses. However, they would be required to revalue these shares to market value every five years and take one-half of the resulting gain or loss into account for tax purposes in that year. A special rate is proposed for widely-held Canadian corporations to avoid double tax. This is explained in Chapter 4.

3.36 The proposal that the accrued gains or losses on those shares be taken into account every five years is one of two exceptions to the general rule that capital gains and losses would be taxable only when they are realized. (The other exception concerns taxpayers who leave Canada.) Periodic revaluation would reduce somewhat the value of the half-gains rule. It would reflect the fact that these shares are readily marketable and that a taxpayer can, therefore, realize his gain or loss fairly easily at the time of his choosing. The shares of private companies do not have the same marketability.

3.37 Periodic revaluation would also reduce the "lock-in" effect that might well otherwise occur. If a taxpayer faces a tax on the sale of an investment, and that tax is postponed if he holds on to the investment, he may feel "locked in". As long as he holds, he would have, say, $100 working for him. If he sells, he would have only, say, $90 or $95 to reinvest. Since periodic revaluation would reduce this lock-in effect, it would reduce what might otherwise be an obstacle to the workings of the capital market. Revaluation would also make it feasible for the government to classify more corporate reorganizations and mergers as tax-free transactions than would otherwise be the case, thus removing a tax barrier that might otherwise have impeded transactions that are desirable for economic reasons. Finally, it would reduce the tax postponement which would otherwise result from the treatment suggested in paragraph *3.42* to those cases where the lack of marketability of the assets made the treatment compelling.

3.38 The process would not begin until five years after capital gains become taxable. Beginning in the fifth year, individual taxpayers would revalue their holdings of shares of widely-held Canadian corporations in each year in which they attain an age that is divisible by five. Corporations would also revalue their holdings of these shares every five years, likely on the fifth anniversary of incorporation and each other anniversary divisible by five. Dispersing the valuation process through a five-year cycle would reduce the pressure in any particular year—the pressure of the work load on the administration and the pressure that might otherwise develop on market prices every five years. To further disperse this latter pressure, it is proposed that revaluation take place as of the end of the month in which the significant birthday or anniversary takes place.

4.43 These proposals obviously put considerable importance on the distinction to be drawn between closely-held Canadian corporations and widely-held Canadian corporations. The rules proposed for defining a widely-held corporation are as follows:

(1) All corporations with shares listed on a prescribed Canadian stock exchange on the day the White Paper is published would be deemed to be widely-held corporations.

(2) All corporations which subsequently list their shares on these exchanges would become widely-held corporations on the day on which their shares are so listed.

(3) Corporations which can meet specified tests concerning the number of shareholders and the number of shares held by those shareholders could elect to be classified as widely-held corporations.

(4) The Minister of National Revenue would have the power to designate other corporations as widely-held corporations if they meet certain tests relating to number of shareholders, dispersal of shares and public trading in shares. (In practice this would mean that most corporations with shares traded "over the counter" would be classified as widely-held corporations.)

(5) Once a corporation is classified as a widely-held corporation it would always remain a widely-held corporation.

Only corporations incorporated in Canada would be eligible to be treated as Canadian widely-held corporations.

4.44 From the time a corporation becomes a widely-held corporation shareholders would receive credit for only half the tax paid by the corporation. Any creditable tax on hand at the time of transition would effectively be cut in half.

4.45 Proceeds from the sale of a share of such a corporation after it becomes a widely-held corporation would be taken into income for tax purposes to the extent of 50 per cent, even though part of the increase in value may well have occurred while the corporation was a closely-held corporation. This provision reflects the expectation that closely-held corporations would distribute—either by cash dividend or stock dividend—almost all of their profits to their shareholders, and that the accruing capital gain, if any, on such shares would therefore relate almost entirely to the expectation that the corporation would be able to earn greater profits in future. Because the shareholders would receive credit for only half of the corporation tax paid on these future profits, it is reasonable that the government collect tax only at half rates on the sale of those future profits.

I - Taxation of Gains Realized on Sale of Shares of Closely-Held Corporations

3.31 The definition of a closely-held Canadian corporation is given in Chapter 4, but it would include most Canadian private corporations. Gains on the sale of shares of these corporations would be fully taxed, and losses on the sale of such shares would be fully deductible (subject to protection against the deduction of personal expenses). This treatment, when coupled with the credit given to Canadian shareholders for the Canadian corporate tax paid by these companies, (see Chapter 4) would produce a balanced system in which there is little if any tax advantage to be secured by a taxpayer through receiving his share of the income of the corporation in the form of gains on the sale of shares rather than dividends, or vice versa. This would remove one of the strongest temptations to tax avoidance in the present act. It would also produce a system in which the weight of tax on private companies is identical to that on the unincorporated businesses with which they compete. This balance is explained more fully in Chapter 4.

4.33 Meanwhile gains realized on the sale of shares in closely-held corporations would be taxed as ordinary income, and losses suffered on the sale of such shares would be deductible from other income for tax purposes. When coupled with the system of full integration, this would mean that the tax effects would be the same whether an individual causes his corporation to sell its assets to a prospective purchaser or chooses to sell his shares to that purchaser, thereby giving the purchaser indirect control of the assets.

4.74 The full deductibility of capital losses suffered on the disposal of shares of closely-held Canadian corporations gives rise to a need for special transitional arrangements affecting those corporations. This need may best be explained by giving an example.

4.75 A corporation which purchased an apartment building 10 years ago might now have a balance sheet somewhat as follows:

Apartment building, at cost		$500,000
Less accumulated depreciation		200,000
		300,000
Land, at cost		50,000
Total assets		$350,000
Mortgage payable		$205,000
Shareholder's equity:		
Common shares	$75,000	
Accumulated earnings	70,000	145,000
		$350,000

4.76 Under the existing system, the shareholders of the corporation would be liable for personal tax if the accumulated earnings of $70,000 were distributed. Further, if the apartment building could be sold for $500,000, there would be corporation tax due on the $200,000 of recaptured depreciation, and personal tax as well when the net proceeds were distributed to the shareholders.

4.77 Assuming the shares of this corporation are worth $345,000 at the start of the system ($500,000 for the building plus $50,000 for the land, less $205,000 for the mortgage), both of these taxes would be forgiven. The corporation would still pay a tax on the recapture of the depreciation ($200,000 at 50 per cent = $100,000) and a dividend of the resulting accumulated earnings of $170,000 would still need to be reported by the shareholders as income of $270,000, including the taxable credit of $100,000. However, on winding up the corporation, the shareholders would have a deductible loss of $270,000—their opening valuation of $345,000 less $75,000 received on winding up. This loss would offset the dividend income and the shareholders would receive a refund of the $100,000 corporation tax paid by the corporation.

J - Taxation of Gains Realized on Sale of Shares of Widely-Held Corporations

3.32 The final category of assets for special mention consists of shares in widely-held Canadian companies. Again, this phrase is defined in Chapter 4, but it would include listed Canadian companies and Canadian companies whose shares are traded over the counter.

3.33 Taxpayers other than widely-held Canadian corporations would include only one-half of their gains on the sale of these shares in taxable income and deduct only one-half of their losses. However, they would be required to revalue these shares to market value every five years and take one-half of the resulting gain or loss into account for tax purposes in that year. A special rate is proposed for widely-held Canadian corporations to avoid double tax. This is explained in Chapter 4.

3.34 The rule that only one-half of gains or losses would be taken into account for tax purposes would put Canadians in approximately the same tax position regarding capital gains and losses on these shares as most of the non-residents who invest in Canada. Specifically, it would put them on approximately the same footing as American individuals and corporations and British individuals and corporations. (It would be impracticable to attempt to tax non-residents on their profits on the sale of small blocks of publicly listed Canadian shares.)

3.35 The 50-per-cent taxability of such gains, coupled with the 50-per-cent credit for corporate tax paid by such corporations, should also result in a relatively balanced system in which there is little incentive for Canadians to receive their income in the form of capital gains rather than dividends, or vice versa. Again this balance is explained more fully in Chapter 4.

3.36 The proposal that the accrued gains or losses on those shares be taken into account every five years is one of two exceptions to the general rule that capital gains and losses would be taxable only when they are realized. (The other exception concerns taxpayers who leave Canada.) Periodic revaluation would reduce somewhat the value of the half-gains rule. It would reflect the fact that these shares are readily marketable and that a taxpayer can, therefore, realize his gain or loss fairly easily at the time of his choosing. The shares of private companies do not have the same marketability.

4.42 As mentioned above and in Chapter 3, the government proposes that half of the gain on the disposal of a share of a Canadian public corporation be taken into account in computing taxable income. This lower rate of tax on the gain would complement the partial credit given for corporate tax and provide the other half of the government's incentive to Canadians to invest in Canadian corporations. To forestall a fairly straightforward tax-avoidance technique, it would be necessary to grant deduction for only half of the loss on the sale of such a share.

4.44 From the time a corporation becomes a widely-held corporation shareholders would receive credit for only half the tax paid by the corporation. Any creditable tax on hand at the time of transition would effectively be cut in half.

4.45 Proceeds from the sale of a share of such a corporation after it becomes a widely-held corporation would be taken into income for tax purposes to the extent of 50 per cent, even though part of the increase in value may well have occurred while the corporation was a closely-held corporation. This provision reflects the expectation that closely-held corporations would distribute—either by cash dividend or stock dividend—almost all of their profits to their shareholders, and that the accruing capital gain, if any, on such shares would therefore relate almost entirely to the expectation that the corporation would be able to earn greater profits in future. Because the shareholders would receive credit for only half of the corporation tax paid on these future profits, it is reasonable that the government collect tax only at half rates on the sale of those future profits.

K - Deemed Realization if Taxpayer Changes Residence from Canada or Takes up Residence in Canada

3.40 The other deemed realization would occur when a taxpayer gives up Canadian residence. The general rule would be that he would be treated as if he had sold all his assets on that day at their fair market value. On the other hand, when a taxpayer moves to Canada he would generally be treated as though he had on that day purchased his assets at their fair market value. The combination of these two rules would mean that Canada would tax only the increase in value that arises during the time that the owner is resident in Canada.

L - Taxation of Gains Realized by a Canadian Public Corporation on the Sale of Shares of Another Canadian Public Corporation

4.59 Special rules are needed to cover the case of a public corporation which receives a dividend from another public corporation. If the dividend were taxable at normal corporate rates, the effect would be to collect more corporate tax in those instances where there are intercorporate holdings than in those instances where the individual shareholder holds his share in the operating corporation in his own name. To overcome this shortcoming it is proposed that a special tax rate be applied to the dividends received by Canadian public corporations from other Canadian public corporations. The rate would be 33⅓ per cent so that this type of intercorporate dividend would be tax-free provided the corporation paying the dividend had paid sufficient Canadian corporate tax to cover the dividend. This special rate would also be applied to capital gains realized by one Canadian public corporation on the sale of shares in another Canadian public corporation. Finally, the loss suffered by one Canadian public corporation on the sale of a share in another Canadian public corporation would reduce tax only at this special rate. The effect of this rate on dividends passing through an intercorporate chain is illustrated in the following schedule:

	Corporate Chain	*Direct Ownership*
Dividend paid by public corporation No. 1	$100	$100
Public corporation No. 2		
Dividend received	100	
Plus taxable credit	50	
Taxable amount	150	
Gross tax, at 33⅓%	50	
Less credit	50	
Net tax	0	
Amount available for distribution	100	
Creditable tax (gross tax amount)	$ 50	
Individual shareholder		
Dividend received	$100	$100
Taxable credit	$ 50	$ 50

M – Gifts and Bequests

3.41 Special rules would be required to provide equitable treatment should a person give an asset to someone. The act now contains rules that apply when depreciable property is transferred by gift. Under these rules, the person making the gift is treated as if he had sold the asset for its fair market value and then made a gift of the proceeds. The person receiving the property is treated as if he had purchased the asset for its fair market value. These same rules would apply if other kinds of property are gifted during the lifetime of the donor.

3.42 If the same rules applied when property was transferred on the death of the owner, it is possible that two taxes could apply at the same time—an income tax on the capital gains accrued on assets owned by the deceased, and an estate tax on the property which he leaves. Further, these taxes could apply at a most inconvenient time. To avoid this situation, the government proposes that capital gains not be accrued at the time of death but that the person who inherits the assets be treated as if he had purchased them at their cost to the deceased. This cost would be increased by part of the death taxes paid on the assets in question—the part that relates to the capital gain. In this way, there would not be a capital gains tax unless or until the executor or beneficiary disposes of the asset.

N – Proceeds of Insurance and of Expropriations

3.44 Examples of forced realizations are expropriations and the collection of insurance proceeds or damage claims in connection with the destruction of an asset. In either of these cases, if the taxpayer uses the whole of the proceeds to purchase similar property within a year of the receipt of the proceeds, a gain that would otherwise be taxable would be treated as a reduction in the cost to him of the new property. Therefore, the gain would only be taken into account for tax purposes if and when he disposes of the replacement property. If he should spend less than the full proceeds, any amount that he keeps would be considered to be part of the gain and would be taxable immediately. In that case, of course, that part of the gain would not reduce the cost to him of the replacement property. As explained earlier, this same process would apply where a taxpayer uses the proceeds of sale of one home to buy another home in connection with certain changes of employment.

O – Transfers of Assets to a Controlled Corporation

3.45 The second type of transaction which would qualify for a rollover would almost always involve a corporation. If a taxpayer transfers some of his assets to a corporation in which he owns all of the shares, there is a sale within the legal definition of that word, but there has been no change in the underlying beneficial ownership of the asset. The government proposes that this fact be recognized by treating the transaction as though it had been a sale at the cost to the taxpayer of the property transferred. Tax would be postponed until either the corporation sells the assets or the individual sells his shares in the corporation.

3.46 For example, suppose that a taxpayer owns an apartment building in which his undepreciated capital cost is $300,000 but which has a market value of $500,000. If the taxpayer transfers this apartment building to a corporation in exchange for the common shares of the corporation, then, assuming he owns all of the shares of the corporation, there would be no taxable gain at the time of the transfer. Rather, the corporation would be treated as having purchased the building for $300,000, and the taxpayer would be treated as having purchased the common shares of the corporation for $300,000. If either subsequently sells its asset, tax would then become due.

P – Transfer of Assets to a Foreign Corporation

3.47 For technical reasons, this rollover must be restricted in three ways. First, it cannot be granted with respect to transfers to foreign corporations, otherwise the gains might slide right through the Canadian tax net untouched. Nor can it be granted with respect to transfers to widely-held Canadian corporations or with respect to transfers of shares of widely-held Canadian corporations. Since gains on the sale of those shares would be only 50-per-cent taxable and losses only 50-per-cent deductible, the provisions necessary to achieve the appropriate ultimate result would be too complex.

Q – Transfer of Assets to a Foreign Corporation

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R – Transfer of Shares of a Widely-Held Corporation to a Controlled Corporation

3.47 For technical reasons, this rollover must be restricted in three ways. First, it cannot be granted with respect to transfers to foreign corporations, otherwise the gains might slide right through the Canadian tax net untouched. Nor can it be granted with respect to transfers to widely-held Canadian corporations or with respect to transfers of shares of widely-held Canadian corporations. Since gains on the sale of those shares would be only 50-per-cent taxable and losses only 50-per-cent deductible, the provisions necessary to achieve the appropriate ultimate result would be too complex.

S – Transfer of Assets to a Partnership

3.48 This treatment of transfers would also apply at the time of incorporation of a partnership, provided the partners have exactly the same economic interest after the incorporation as they had before. Generally this would mean that they would have to receive the same proportion of every class of share or claim against the corporation as they previously were entitled to receive of partnership profits and assets.

T - Winding-Up of a Closely-Held Corporation

3.49 Somewhat similar rules would govern on the winding-up of a closely-held Canadian corporation. If there is only one shareholder, the tax treatment would be designed to put the parties in the same position as if, first, the corporation had sold its assets to that shareholder for a price equal to the cost to him of his shares in the corporation, and then the corporation had distributed those proceeds on winding-up. If there is more than one shareholder, the treatment would be similar provided all shareholders have exactly the same economic interest after liquidation as before.

U - Distributions on Re-Organization of a Corporation

3.50 If a corporation splits its shares without increasing its paid-up capital, it would be a tax-free transaction and each shareholder would spread the cost to him of the old shares over the larger number of new shares. If, however, the corporation includes something else in the transaction—for example, in a reorganization involving common shares it includes debt claims or shares that are not common shares—it is proposed that shareholders be treated as having realized their potential capital gain to the extent of the value of this other asset that they have received. Also, if rights are varied in the reorganization—some shareholders receiving one thing and other shareholders of the same class receiving something else—it is proposed that it be a taxable transaction.

3.51 Most other reorganizations or mergers involve a change in economic interest—a barter. It is proposed that, at least initially, these transactions be treated as taxable realizations if they involve closely-held Canadian corporations or foreign corporations. It may still be possible later to identify more situations in which a rollover can be granted without permitting taxpayers to accomplish tax-free in an indirect manner what would be taxable if done directly.

V - Speculative Land Profits

3.53 Paragraph *3.15* sets out the general rule that taxpayers could deduct from the proceeds of sale of assets the value of those assets on valuation day. If this rule were applied to all assets, some Canadians would be excused from tax under the new system who would have been taxable under the present system. For example, a land speculator who purchases a farm for less than its current value is taxable under the existing system if he sells that farm. It would be perverse if a change that was designed to increase the percentage of the income of the wealthy that is brought to tax should in this particular instance create an exemption for the speculator. The law would be drafted in such a way as to make sure this does not happen.

W - Recaptured Capital Cost Allowances

3.54 Another example concerns taxpayers who own depreciable property that they are using for income-earning purposes. Consider the case of a taxpayer who bought an apartment building for $500,000 and has over the years claimed depreciation for tax purposes of $200,000. Under the present system if he sells the apartment building for more than $300,000, the next $200,000 is treated as a "recapture" of the depreciation he has been permitted and either directly or indirectly comes into the computation of his taxable income. Only if he sells the building for more than $500,000 will any part of the proceeds be considered a capital gain—the excess over $500,000. The act would be drawn up in such a way as to make it clear that the taxpayer is still liable for tax on recaptured depreciation.

X - Taxation of Capital Gains of a Non-Resident

3.34 The rule that only one-half of gains or losses would be taken into account for tax purposes would put Canadians in approximately the same tax position regarding capital gains and losses on these shares as most of the non-residents who invest in Canada. Specifically, it would put them on approximately the same footing as American individuals and corporations and British individuals and corporations. (It would be impracticable to attempt to tax non-residents on their profits on the sale of small blocks of publicly listed Canadian shares.)

6.43 The general proposal to include capital gains in taxable income would require changes to the international provisions, including the extension of Canadian tax to gains by non-residents on the disposal of real property, partnership interests and branch assets in Canada.

6.44 Given the ease with which a gain on the sale of other assets can be transformed into a gain on the sale of shares of a corporation, it would also be necessary to tax certain gains by non-residents on the sale of Canadian shares. This need is strongly reinforced as regards closely-held Canadian corporations by the implications of the regime suggested for Canadian shareholders of those corporations. Since a Canadian can obtain full credit for the Canadian corporate tax paid by the corporation, and can deduct the full cost of his shares from his income when he sells those shares, he can afford to pay the full value of the corporation's assets (including creditable tax as an asset) when he buys the shares of the corporation.

6.45 Consider a corporation in this position:

Assets	
Cash	$ 5,000
Land, at cost	100,000
(present value $150,000)	
	$105,000
Shareholder's equity	
Common shares	$100,000
Retained earnings	
(after tax of $5,000)	5,000
	$105,000

A Canadian could afford to pay $160,000 for the shares of the corporation—$150,000 for the land, $5,000 for the cash, and $5,000 for the creditable tax. If he winds up the company, he would be treated as having purchased the land for $150,000, and as having received a dividend of $5,000 plus a taxable credit of $5,000. Offsetting this he would have a deductible loss of $10,000 on the shares. So he would receive $150,000 worth of land, the $5,000 cash in the corporation and a $5,000 tax refund from the government.

6.46 This is the appropriate result provided the vendor is taxable on his capital gain on the sale of the share. He and/or the owners before him would have paid tax on the full $60,000 on the sale of their shares. Canada would have collected one tax—and only one—on the $60,000. But the vendor must be taxable, or the $60,000 would escape tax. Therefore it is proposed that non-residents as well as residents be taxed on their gains on the sale of shares of closely-held Canadian corporations. This would be buttressed by a "back-up" provision to place a responsibility on the purchaser to ensure compliance. A system of "certificates of compliance" would be necessary for private company share transfers—an awkward but necessary evil.

6.47 The same implications do not apply in the case of widely-held Canadian corporations. Canadian shareholders would receive credit for only half of the corporate tax paid and would be entitled to deduct only half of their loss on the sale of their shares. Also, it would be impracticable to attempt to tax non-residents on their sales of small lots of these shares. Therefore it is proposed that only those non-residents who are selling shares out of a substantial interest (25 per cent or more) would be taxable in Canada.

Y - Mutual Funds

4.61 Open-end mutual funds and most closed-end mutual funds would be widely-held corporations under the definitions proposed earlier in this chapter. As a result shareholders would receive the dividends that flow through the mutual fund subject to the same tax as if they had received the dividends directly. There is one exception to this, in the case of dividends from a closely-held corporation that are routed through a mutual fund. In this instance the government feels it appropriate to levy the same taxes on this portion of the corporate income as if the earnings had been in a public corporation. The relationship of the shareholder of the mutual fund to his corporation is much the same as that of shareholders of other public corporations to their corporations.

4.62 A special rule would, however, be required for mutual funds. This type of corporation must be able to put its shareholders in the same position as if they themselves had realized their proportion of the capital gains of the mutual fund arising on the sale of shares in public Canadian corporations. In the absence of a special provision mutual fund shareholders would pay tax on the full amount of such gains when they were distributed to them, whereas tax should be applied only to half of the gain. Consequently this type of corporation would be enabled to make special distributions to its shareholders which would be treated as though they were a capital gain on the sale of a Canadian public corporation. The effect of this proposal is illustrated below:

	Mutual Fund	*Individual Shareholder*
Gain on sale of shares	$300	$300
Tax:		
At 33⅓% on the gain	100	
At say 40% on one-half of the gain		60
Net gain	200	
Special dividend distributed to shareholders	200	
Taxable credit	100	
Taxable amount	300	
Gross tax, at 40% on one-half	60	
Less credit	100	
Refund	40	
Net amount retained		
Dividend plus refund	$240	
Gain less tax		$240

APPENDIX C

Comparison of

Present Net Federal Taxes and Present Provincial Taxes Computed at 25% of Basic Federal Tax — with — Proposed Net Federal Taxes and Proposed Provincial Taxes Computed at 28% of Proposed Net Federal Taxes As they will be in Second Year of Implementation

Brackets of Taxable Income			Present Net Federal Taxes		Present 28% Provincial Tax		Proposed Net Federal Taxes		Proposed 28% Provincial Tax	
			Tax Payable at beginning of bracket	Rate of Tax within bracket	Tax Payable at beginning of bracket	Rate of Tax within bracket	Tax Payable at beginning of bracket	Rate of Tax within bracket	Tax Payable at beginning of bracket	Rate of Tax within bracket
$ 24,000	to	$ 25,000	$ 6,424	33.75%	$ 2,274	12.60%	$ 7,170	40%	$ 2,008	11.20%
25,000		35,000	6,761	37.50%	2,400	14.00%	7,570	40%	2,120	11.20%
35,000		40,000	10,511	37.50%	3,800	14.00%	11,570	43%	3,240	12.04%
40,000		55,000	12,386	41.25%	4,500	15.40%	13,720	43%	3,842	12.04%
55,000		60,000	18,574	41.25%	6,810	15.40%	20,170	46%	5,648	12.88%
60,000		85,000	20,636	45.00%	7,580	16.80%	22,470	46%	6,292	12.88%
85,000		90,000	31,886	45.00%	11,780	16.80%	33,970	49%	9,512	13.72%
90,000		120,000	34,136	48.75%	12,620	18.20%	36,420	49%	10,198	13.72%
120,000		125,000	48,761	48.75%	18,080	18.20%	51,120	52%	14,314	14.56%
125,000		200,000	51,199	52.50%	18,990	19.60%	53,720	52%	15,042	14.56%
200,000		225,000	90,574	52.50%	33,690	19.60%	92,720	55%	25,962	15.40%
225,000		400,000	103,699	56.25%	38,590	21.00%	106,470	55%	29,812	15.40%
400,000 and up			202,136	60.00%	75,340	22.40%	202,720	58%	56,762	16.24%

Comparison of

Present Net Federal Taxes and Present Provincial Taxes Computed at 28% of Basic Federal Tax

– with –

Proposed Net Federal Taxes and Proposed Provincial Taxes Computed at 28% of Proposed Net Federal Taxes As they will be in Third Year of Implementation

Brackets of Taxable Income			Present Net Federal Taxes		Present 28% Provincial Tax		Proposed Net Federal Taxes		Proposed 28% Provincial Tax	
			Tax Payable at beginning of bracket	Rate of Tax within bracket	Tax Payable at beginning of bracket	Rate of Tax within bracket	Tax Payable at beginning of bracket	Rate of Tax within bracket	Tax Payable at beginning of bracket	Rate of Tax within bracket
$ 24,000	to	$ 25,000	$ 6,424	33.75%	$ 2,274	12.60%	$ 7,170	40%	$ 2,008	11.20%
25,000		35,000	6,761	37.50%	2,400	14.00%	7,570	40%	2,120	11.20%
35,000		40,000	10,511	37.50%	3,800	14.00%	11,570	42%	3,240	11.76%
40,000		55,000	12,386	41.25%	4,500	15.40%	13,670	42%	3,828	11.76%
55,000		60,000	18,574	41.25%	6,810	15.40%	19,970	44%	5,592	12.32%
60,000		85,000	20,636	45.00%	7,580	16.80%	22,170	44%	6,208	12.32%
85,000		90,000	31,886	45.00%	11,780	16.80%	33,170	46%	9,288	12.88%
90,000		120,000	34,136	48.75%	12,620	18.20%	35,470	46%	9,932	12.88%
120,000		125,000	48,761	48.75%	18,080	18.20%	49,270	48%	13,796	13.44%
125,000		200,000	51,199	52.50%	18,990	19.60%	51,670	48%	14,468	13.44%
200,000		225,000	90,574	52.50%	33,690	19.60%	87,600	50%	24,548	14.00%
225,000		400,000	103,699	56.25%	38,590	21.00%	100,170	50%	28,048	14.00%
400,000 and up			202,136	60.00%	75,340	22.40%	187,670	52%	52,548	14.56%

Comparison of

Present Net Federal Taxes and Present Provincial Taxes Computed at 28% of Basic Federal Tax

\- with -

Proposed Net Federal Taxes and Proposed Provincial Taxes Computed at 28% of Proposed Net Federal Taxes As they will be in Fourth Year of Implementation

Brackets of Taxable Income			Present Net Federal Taxes: Tax Payable at beginning of bracket	Present Net Federal Taxes: Rate of Tax within bracket	Present 28% Provincial Tax: Tax Payable at beginning of bracket	Present 28% Provincial Tax: Rate of Tax within bracket	Proposed Net Federal Taxes: Tax Payable at beginning of bracket	Proposed Net Federal Taxes: Rate of Tax within bracket	Proposed 28% Provincial Tax: Tax Payable at beginning of bracket	Proposed 28% Provincial Tax: Rate of Tax within bracket
$ 24,000	to	$ 25,000	$ 6,424	33.75%	$ 2,274	12.60%	$ 7,170	40%	$ 2,008	11.20%
25,000		35,000	6,761	37.50%	2,400	14.00%	7,570	40%	2,120	11.20%
35,000		40,000	10,511	37.50%	3,800	14.00%	11,570	41%	3,240	11.48%
40,000		55,000	12,386	41.25%	4,500	15.40%	13,620	41%	3,814	11.48%
55,000		60,000	18,574	41.25%	6,810	15.40%	19,770	42%	5,536	11.76%
60,000		85,000	20,636	45.00%	7,580	16.80%	21,870	42%	6,124	11.76%
85,000		90,000	31,886	45.00%	11,780	16.80%	32,370	43%	9,064	12.04%
90,000		120,000	34,136	48.75%	12,620	18.20%	34,520	43%	9,666	12.04%
120,000		125,000	48,761	48.75%	18,080	18.20%	47,420	44%	13,278	12.32%
125,000		200,000	51,199	52.50%	18,990	19.60%	49,620	44%	13,394	12.32%
200,000		225,000	90,574	52.50%	33,690	19.60%	82,620	45%	23,134	12.[illegible]%
225,000		400,000	103,699	56.25%	38,590	21.00%	93,870	45[illegible]	26,284	12.[illegible]
400,000 and up			202,136	60.00%	75,340	22.40%	172,620	46%	48,334	12.88%

Comparison of

Present Net Federal Taxes and Present Provincial Taxes Computed at 28% of Basic Federal Tax

\- with -

Proposed Net Federal Taxes and Proposed Provincial Taxes Computed at 28% of Proposed Net Federal Taxes

As they will be in Fifth Year of Implementation

Brackets of Taxable Income			Present Net Federal Taxes		Present 28% Provincial Tax		Proposed Net Federal Taxes		Proposed 28% Provincial Tax	
			Tax Payable at beginning of bracket	Rate of Tax within bracket	Tax Payable at beginning of bracket	Rate of Tax within bracket	Tax Payable at beginning of bracket	Rate of Tax within bracket	Tax Payable at beginning of bracket	Rate of Tax within bracket
$ 24,000	to	$ 25,000	$ 6,424	33.75%	$ 2,274	12.60%	$ 7,170	40%	$ 2,008	11.20%
25,000		35,000	6,761	37.50%	2,400	14.00%	7,570	40%	2,120	11.20%
35,000		40,000	10,511	37.50%	3,800	14.00%	11,570	40%	3,240	11.20%
40,000		55,000	12,386	41.25%	4,500	15.40%	13,570	40%	3,800	11.20%
55,000		60,000	18,574	41.25%	6,810	15.40%	19,570	40%	5,480	11.20%
60,000		85,000	20,636	45.00%	7,580	16.80%	21,570	40%	6,040	11.20%
85,000		90,000	31,886	45.00%	11,780	16.80%	31,570	40%	8,840	11.20%
90,000		120,000	34,136	48.75%	12,620	18.20%	33,570	40%	9,400	11.20%
120,000		125,000	48,761	48.75%	13,080	18.20%	45,570	40%	12,760	11.20%
125,000		200,000	51,199	52.50%	18,990	19.60%	47,570	40%	13,320	11.20%
200,000		225,000	90,574	52.50%	33,690	19.60%	77,570	40%	21,720	11.20%
225,000		400,000	103,699	56.25%	38,590	21.00%	87,570	40%	24,520	11.20%
400,000 and up			202,136	60.00%	75,340	22.40%	157,570	40%	44,120	11.20%

TAXATION OF DIVIDENDS RECEIVED
BY INDIVIDUALS FROM CANADIAN
WIDELY-HELD CORPORATIONS

Under our present system dividends received by individuals from taxable Canadian corporations are taxed according to the following formula:

	Federal	Provincial
Dividends received from Canadian corporations, before deducting personal exemptions	100%	100%
Tax payable under present system	Computed under present schedules	Percentage of basic federal tax
Less 20% Canadian dividend credit	20% of dividend	
Basic federal tax	XXX	
Less 28% provincial tax credit	28% of basic federal tax	
	XXX	
Add sundry surcharges	XXX	
Tax payable	XXX	XXX

Under the proposed system, dividends received by an individual from Canadian widely-held corporations will be taxed according to the following formula:

	Federal	Provincial
Dividends received from Canadian widely-held corporations	100%	100%
Add: Taxable credit, equal to 50% of dividends received	50%	50%
Income, before deducting personal exemptions	150%	150%
Tax payable under proposed system	Computed under proposed schedules	28% of federal tax
Less Credit for corporation taxes paid of 50% divided between Canada and the province in the ratio of 40:10	40% of dividend	10% of dividend
Tax payable	XXX	XXX

Under our present system, the individual is given a credit of 20% of the total Canadian dividends received when computing his liability to federal and provincial income taxes.

Under the proposed system, the individual is taxed on 150% of the total dividends received from Canadian widely-held corporations and is given a credit of 40% of the dividends received when computing federal taxes and is given a credit of 10% of the dividends received when computing provincial taxes.

The White Paper makes no proposals respecting the corporation taxes in excess of 10% presently levied by most provinces, but assumes that all provinces will reduce corporation taxes to a standard rate of 10%.

There is attached a schedule contrasting the federal and provincial taxes payable on certain amounts of earned income and on dividend income under our present and proposed systems.

TAXPAYER - UNMARRIED STATUS - NO DEPENDENTS

	Present Law Tax Payable to			Proposed Law Tax Payable to			Variation in Tax Payable to		
Earned Income	Canada	28% Province	Total	Canada	28% Province	Total	Canada	28% Province	Total
$ 5,000	651	166	817	657	184	841	+ 6	+ 18	+ 24
10,000	1,713	516	2,229	1,938	542	2,480	+ 225	+ 26	+ 251
13,000	2,460	794	3,254	2,805	785	3,590	+ 345	- 9	+ 336
15,000	3,056	1,017	4,073	3,415	956	4,371	+ 359	- 61	+ 298
20,000	4,704	1,631	6,335	5,136	1,438	6,574	+ 432	- 193	+ 239
25,000	6,390	2,261	8,651	6,936	1,942	8,878	+ 546	- 319	+ 227
Investment Income - Dividends from Widely-Held Corporation									
5,000	234	-	234	(700)	(136)	(836)	- 934	- 136	- 1,070
10,000	360	-	360	(535)	(30)	(565)	- 895	- 30	- 925
13,000	510	66	576	(190)	103	(87)	- 700	+ 37	- 663
15,000	806	176	982	90	205	295	- 716	+ 29	- 687
20,000	1,703	511	2,214	970	512	1,482	- 733	+ 1	- 732
25,000	2,640	861	3,501	2,010	863	2,873	- 630	+ 2	- 628

( ) denotes refund

Second Session—Twenty-eighth Parliament
1969-70

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE
ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 9

WEDNESDAY, FEBRUARY 11, 1970

Complete Proceedings on Bills S-18, S-20 and C-9,

intituled respectively:

"An Act respecting Brunner Corporation (Canada) Limited";
"An Act respecting the labelling, sale, importation and advertising of consumer textile articles" and
"An Act to amend the Small Businesses Loans Act".

WITNESSES:

Brunner Corporation (Canada) Limited: J. L. D. King, Parliamentary Agent. *Department of Consumer and Corporate Affairs:* The Honourable Ron Basford, Minister, and G. F. Osbaldeston, Assistant Deputy Minister. *Department of Finance:* J. A. Renwick, Government Finance Division.

REPORTS OF THE COMMITTEE

21624—1

THE STANDING SENATE COMMITTEE ON
BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aseltine	Desruisseaux	Kinley
Beaubien	Everett	Lang
Benidickson	Gélinas	Leonard
Blois	Giguère	Macnaughton
Burchill	Grosart	Molson
Carter	Haig	Phillips (*Rigaud*)
Choquette	Hayden	Walker
Connolly (*Ottawa West*)	Hays	Welch
Cook	Hollett	White
Croll	Isnor	Willis—(30)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extracts from the Minutes of the Proceedings of the Senate, February 5, 1970:

"Pursuant to the Order of the Day, the Honourable Senator Lang moved, seconded by the Honourable Senator Burchill, that the Bill S-18, intituled: "An Act respecting Brunner Corporation (Canada) Limited", be read the second time.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative.

The Bill was then read the second time.

The Honourable Senator Lang moved, seconded by the Honourable Senator Burchill, that the Bill be referred to the Standing Senate Committee on Banking, Trade and Commerce.

The question being put on the motion, it was—
Resolved in the affirmative."

"Pursuant to the Order of the Day, the Honourable Senator Benidickson, P.C., moved, seconded by the Honourable Senator Peterson, that the Bill C-9, intituled: "An Act to amend the Small Businesses Loans Act", be read the second time.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative.

The Bill was then read the second time.

The Honourable Senator Benidickson, P.C., moved, seconded by the Honourable Senator Lamontagne, P.C., that the Bill be referred to the Standing Senate Committee on Banking, Trade and Commerce.

The question being put on the motion, it was—
Resolved in the affirmative."

ROBERT FORTIER,
Clerk of the Senate.

Extract from the Minutes of the Proceedings of the Senate, February 10, 1970:

"Pursuant to the Order of the Day, the Senate resumed the debate on the motion of the Honourable Senator Phillips (*Rigaud*), seconded by the Honourable Senator Robichaud, P.C., for the second reading of the Bill S-20, intituled: "An Act respecting the labelling, sale, importation and advertising of consumer textile articles".

21624—1½

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative.

The Honourable Senator Phillips (*Rigaud*) moved, seconded by the Honourable Senator Macnaughton, P.C., that the Bill be referred to the Standing Senate Committee on Banking, Trade and Commerce.

The question being put on the motion, it was—
Resolved in the affirmative."

ROBERT FORTIER,
Clerk of the Senate.

MINUTES OF PROCEEDINGS

WEDNESDAY, February 11, 1970.
(11)

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to consider the following Bills:

Bill S-18, "An Act respecting Brunner Corporation (Canada) Limited"

Bill S-20, "An Act respecting the labelling, sale, importation and advertising of consumer textile articles"

Bill C-9, "An Act to amend the Small Businesses Loans Act".

Present: The Honourable Senators Hayden (*Chairman*), Beaubien, Benidickson, Blois, Burchill, Carter, Connolly (*Ottawa West*), Cook, Desruisseaux, Flynn, Everett, Giguere, Grosart, Haig, Hays, Hollett, Isnor, Kinley, Lang, Leonard, Macnaughton and Phillips (*Rigaud*)—(22).

Present, but not of the Committee: The Honourable Senators Aird, Phillips (*Prince*) and Sullivan—(3).

In attendance: E. Russell Hopkins, Law Clerk and Parliamentary Counsel.

Bill S-18, "An Act respecting Brunner Corporation (Canada) Limited".

The following witness was heard:

J. L. D. King,
Parliamentary Agent.

Upon motion it was Resolved to report the said Bill without amendment.

At 9:10 a.m. the Committee proceeded to the next order of business.

9:10 a.m.

Bill S-20, "An Act respecting the labelling, sale, importation and advertising of consumer textile articles".

The following witnesses were heard:

Department of Consumer and Corporate Affairs:

The Honourable Ron Basford,
Minister.
G. F. Osbaldeston,
Assistant Deputy Minister.

Upon motion it was Resolved to amend Clause 2 (d) (ii) and Clause 5(1).

NOTE: The full text of the above amendments will be found by reference to the Report of the Committee immediately following these Minutes.

Upon motion it was Resolved to report the said Bill as amended.

At 10:30 a.m. the Committee proceeded to the next order of business.

10:30 a.m.

Bill C-9, "An Act to amend the Small Businesses Loans Act".

The following witness was heard:

Department of Finance:

J. A. Renwick,
Government Finance Division.

Upon motion it was Resolved to report the said Bill without amendment.

At 10:40 a.m. the Committee proceeded to its examination of the White Paper on Tax Reform.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

REPORTS OF THE COMMITTEE

WEDNESDAY, February 11th, 1970.

The Standing Senate Committee on Banking, Trade and Commerce to which was referred the Bill S-18, intituled: "An Act respecting Brunner Corporation (Canada) Limited", has in obedience to the order of reference of February 5th, 1970, examined the said Bill and now reports the same without amendment.

Respectfully submitted.

SALTER A. HAYDEN,
Chairman.

WEDNESDAY, February 11, 1970.

The Standing Senate Committee on Banking, Trade and Commerce to which was referred the Bill S-20, intituled: "An Act respecting the labelling, sale, importation and advertising of consumer textile articles", has in obedience to the order of reference of February 10th, 1970, examined the said Bill and now reports the same with the following amendments:

1. *Pages 1 and 2:* Strike out sub-paragraph (ii) of paragraph (d) of clause 2 in the English and French versions of the Bill and substitute therefor the following:

   "(ii) Any product made in whole or in part from a textile fibre, yarn or fabric that is in the form in which it is or is to be sold to any person for consumption or use, other than consumption or use in the manufacturing, processing or finishing of any product for sale;"

2. *Page 3:* Strike out sub-clause (1) of clause 5 in the English version of the Bill only and substitute therefor the following:

   "5. (1) No dealer shall apply to a consumer textile article a label, or sell, import into Canada or advertise a consumer textile article that has applied to it a label, that contains any false or misleading representation relating to or that may reasonably be regarded as relating to the article."

Respectfully submitted.

SALTER A. HAYDEN,
Chairman.

WEDNESDAY, February 11th, 1970.

The Standing Committee on Banking, Trade and Commerce to which was referred the Bill C-9, intituled:: "An Act to amend the Small Businesses Loans Act", has in obedience to the order of reference of February 5th, 1970, examined the said Bill and now reports the same without amendment.

Respectfully submitted.

SALTER A. HAYDEN,
Chairman.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Ottawa, Wednesday, February 11, 1970

The Standing Senate Committee on Banking, Trade and Commerce, to which was referred Bill S-18, respecting Brunner Corporation (Canada) Limited, met this day at 9 a.m. to give consideration to the bill.

Senator Salter A. Hayden (Chairman) in the Chair.

The Chairman: Honourable senators, we have a private bill and two public bills, and when we have dealt with those we will continue our consideration of the White Paper.

Our first bill is S-18 respecting the Brunner Corporation (Canada) Limited. May we have the usual motion to print.

> Upon motion, it was *resolved* that a verbatim report be made of the proceedings and to recommend that 800 copies in English and 300 copies in French be printed.

The Chairman: Senator Lang, have you anything to add to what you have already said concerning this bill?

Senator Lang: I have nothing to add to what I have already said.

The Chairman: Mr. E. F. O'Neill, President of Brunner Corporation, is here together with Mr. Jeffrey L. D. King, the Parliamentary Agent. Will you come forward, please?

Mr. Jeffrey L. D. King, Parliamentary Agent, Brunner Corporation (Canada) Limited: Mr. Chairman and honourable senators, the facts which give rise to this bill S-18 are basically that the comptroller of Brunner Corporation displayed some negligence in the carrying out of his functions in failing to file the necessary returns for the years 1966 to 1968 inclusive. This negligence resulted in the revocation of the letters patent of the company. This bill is now in front of you with a view to having it deemed that the letters patent have never been revoked. Mr. O'Neill who is the president is present this morning to answer any questions you may wish to ask. As I have said, honourable senators, the facts giving rise to the presentation of this bill were simply the result of the negligence on the part of one of our employees.

The Chairman: When was this bill passed into law originally, Mr. King? Do you have the date? As you aware, the Brunner Corporation was established by Act of Parliament.

Mr. King: The Brunner Corporation was established in 1937.

The Chairman: Was it carrying on business during the period 1966 to 1968 inclusive?

Mr. King: The assets were purchased by Dunham-Bush (Canada) Limited, of which Mr. O'Neill is also the president, with the result that the company was practically dormant. For this reason the comptroller thought there was no obligation to file the annual returns.

The Chairman: Any questions, honourable senators?

Shall I report the bill without amendment?

Hon. Senators: Agreed.

The Chairman: We will now turn to Bill S-20, respecting the labelling, sale, importation and advertising of consumer textile articles.

We have with us the Honourable Ron Basford, Minister of Consumer and Corporate Affairs, who is going to give us a general explanation of the purposes of this bill.

Hon. Ron Basford, Minister of Consumer and Corporate Affairs: Mr. Chairman and honourable senators, I have had the opportunity of reading Senator Lazarus Phillips' very able and full introduction of this bill on second reading, and there is really little I can add to the general explanation that he gave in the Senate last Thursday. However, I

understand from your chairman that you would like a short statement on the record by way of introduction.

I think all honourable senators will be interested in the purposes of this proposal now before you.

Modern consumers are at once the victims and beneficiaries of a revolution in textile technology. The days when cotton, wool and linen were the usual fibres have passed and consumers are now faced with a bewildering variety of blends and mixtures of animal, vegetable and man-made textiles. Many special purpose fabrics are now available. Wearing qualities, allure, comfort and variety have all been improved. But consumers want to know how the incorporation of various fibres in cloth will influence its suitability, durability, comfort, ease of care and attractiveness. It is also true that the mixing and blending of fibres can have important effects on the qualities of fabrics. The number of uses of the fabric may be changed, its tactile characteristics may be varied, not to mention its cost and appearance. The use of trade names may often be helpful, but there are now over 700 trade names for manufactured fibres in North America. Some of these are household words but many are not, and with the inventiveness of industry one can expect the proliferation of new and exotic but often uninformative trade marked designations in the future.

It is our basic contention that consumers should be provided with as much information as they reasonably require to make informed choices and they should not be misled by false or non-existent labelling. It is for these reasons that there is need of a program for the mandatory identification of fibre content in clothing and household textiles.

Because of the close similarity of textile technology in Canada and the United States and the large volume of trade in fabrics and clothing between the two countries, it is desirable that any regulations adopted in Canada be consistent with those of the United States. This could be achieved by using in Canada the generic system of classification adopted under the U.S. Textile Fiber Products Identification Act.

Some of these generic terms are unfamiliar to many people and it is recognized that if this bill becomes law, there will have to be an intensive educational effort to familiarize the buying public with their significance. The consumer will no longer have to deal with the ingenious but confusing proliferation of names such as Estron, Zefran, Vitron, Lurex, Dynel, Caprolan, Meraklon, Kodel, Avril, Narcon, Dawbarn—a list which could be multiplied many times.

The bill before you proposes that mandatory labelling apply to such textile articles as wearing apparel, fabrics sold by the piece, and household textiles such as sheets and curtains. This application extends to any consumer textile fibre product in relation to advertising or false labelling, whether the material is a foreign or domestic product.

The main features of the bill provide for: mandatory labelling of prescribed consumer textile articles to disclose fibre content by generic names and the respective percentages of content of each fibre; prohibition of false, misleading or deceptive representations relating to a textile fibre product; authority for inspection, seizure and detention of suspected articles; authority for the Governor in Council to make regulations required for implementation, and to prescribe articles to be subject to or exempt from the act; offences and punishment upon either indictment or summary conviction with provisions relating to time limitations, trial location, introduction of documentary evidence and forfeiture of articles after conviction. Penalties range from $1,000 to $10,000 and/or imprisonment for up to one year.

That, Mr. Chairman, is a very short introductory statement which is supplementary to the excellent statement Senator Phillips (Rigaud) made on the floor of the Senate.

I have with me my Assistant Deputy Minister, Mr. G. F. Osbaldeston; Miss O. C. Lozinski, Legal Adviser; and Mr. G. R. Lewis, Chief, Commodity Labelling Division, of the Consumer Bureau, who are here to assist me in a technical way, to get me out of the holes I dig myself into.

The Chairman: Are there any questions?

Senator Blois: I asked a number of questions last night, so perhaps I had better continue.

I might say to the minister that I have spent my life in the textile business, and in the last two or three days three manufacturing concerns and one other have contacted me either personally or by telephone. None objects to marking goods; anything will do that will aid the consumer. However, some firms feel—and I must say I agree with

them—that marking, as I understand it, may confuse the consumer much more than it will aid him.

Let me put this to you, and you may have an explanation. Our textiles today, fabrics or various textile products, may contain seven different fibres. That is going to make for a tremendously large label, or it is going to involve such small print or type woven into it that people will not be able to read it. People in the indusry are worried about how they are going to cover this additional expense; and as you probably know, in any business, if you have any additional expense, in the end the consumer pays. If it costs the manufacturer an additional three, four or five cents per garment, the consumer probably pays an additional ten cents. They are not objecting to the idea of marking, which may be helpful to the consumer.

I think perhaps you know what I mean, because you have already mentioned that there are so many different types of fibre. I am not quite sure, but there are between 15 and 20 fibres used by the Canadian manufacturing trade.

Hon. Mr. Basford: In the course of the preparation of this bill we have had extensive consultations with industrial groups in the textile and garment industries, all of whom have indicated, as you did, senator, widespread support for the principle of mandatory textile labelling.

Regarding some of the technical matters concerning the bill, we will be guided in the establishing of regulations both by the American experience, where they appear to have avoided the problems you speak of, and by rather close consultations with the industry itself.

The bill provides that regulations may be made whereby a certain very small percentage of textile fibres in a particular fabric need not be listed, but that the individual fibres be listed in order of importance in the textile.

If the regulations are based upon or drawn from the American experience and from our consultations with industry, I cannot see that any sensible system of mandatory labelling will confuse the consumer more than he presently is. That suggestion I cannot accept.

As to cost, I did not have the opportunity of hearing you in the Senate last night. I understand you were asking some questions. I think that most manufacturers now label a textile or garment. This legislation will provide for certain information which must be printed on that label. I cannot see that that will involve very great additional cost.

Further, with proper labelling there are savings to be had by the retailer and, in some cases, by the manufacturer or the fitter, and by the consumer. They will know precisely what is in the garment or in the cloth which they buy, by which means they will know how it will make up and they can give it better care. Also from the retailer's point of view, without proper labelling there might be complaints and the goods might be returned. From the dry cleaning industry's point of view, they can do a better job and are most anxious to see this done. So I think there are offsetting savings to the economy.

Senator Blois: If, as I say, some fabrics have as many as seven different man-made fibres, is it the intention of the department that each one must be listed on the label?

Hon. Mr. Basford: Yes, save and except—and we will come to it clause by clause in a moment—if they comprise less than 5 per cent.

Senator Blois: Many would be over 5 per cent. Most labels would be, say, one inch in depth. To put all these constituent fibres on the label you would have to make a label much bigger, and this is going to look very bad on the garment.

One manufacturer phoned me and said that they are making their own labels; that they will have to buy new looms which will cost between $15,000 and $20,000 each; that help will have to be trained; and that it will cost much more to make the label and more to put it on. In this particular case, if they had to do that, it would cost them in the vicinity of four to six cents a garment extra. That means the consumer is going to have to pay 15 cents to 20 cents more for that garment. That is the natural way of doing business.

If we were to ask honourable senators here in this room today to name seven or eight fabrics, they would not be able to. This is why I am bringing this up. The manufacturers want everying they can get to protect the consumer. I think I know your worries. There are, and have been for some time, many goods imported and some which are now made in Canada which are not up to standard, and of course the consumer should be protected from these.

Hon. Mr. Basford: I would question that cost figure, to start with, senator. I doubt that it is going to cost an additional four to six cents per label. I just do not accept that figure as being at all realistic.

Senator Blois: Why not, sir?

Hon. Mr. Basford: The person speaking to you is putting the worst interpretation upon the provisions of the bill.

Senator Blois: This is only one of them.

Hon. Mr. Basford: In the second place—and I hesitate to suggest this to you because your knowledge of the textile business is far greater than mine—I cannot imagine at the moment a textile that is made up of 95 per cent of seven of the generic substances that are going to be controlled under this act. I can imagine a product made up of substances with seven different trade names, but those trade names might be applicable only to nylon. I would certainly like to see a textile that has seven generic substances in it. I think it would be a pretty odd textile.

You see, in the act, instead of using the 700 different trade names that are presently in use for man-made fibres, we are dividing them into 16 generic titles. I could give you a list of them senator. I find it hard to conceive of a fabric that would include seven of those generic substances, such as acrylic, modacrylic, polyester, rayon acetate, saran, azlon, nytril, nylon, rubber, spandex, vinal, olefin, vinyon, metallic, and glass. I would like to see a textile that has seven of those in it.

Senator Blois: I think there could very well be one. I have blended many of them at times. I am trying to get the bill clarified. Could there be one name such as "synthetic fibres", rather than having to name all of those different things. Would that help at all?

Hon. Mr. Basford: No, because we have roughly—and this is not completely accurate—the five commonly known natural fibres, and we are taking all of these synthetics or all of the others, and putting them into 16 classifications.

Senator Blois: I notice you included rubber. I do not think anyone would call rubber a synthetic textile fibre. There is a misunderstanding there. Rubber is not a textile fibre.

Hon. Mr. Basford: For the purposes of this act it is deemed to be such if it is used in a garment to an extent in excess of 5 per cent. Certainly any dry cleaner handling that garment would want to know that there is some rubber in it, because that affects the way in which he handles it. Possibly you could say that paper is not a textile, but...

Senator Blois: Some textile fibres go into the making of paper. I realize that I am not getting very far on that, so I will try another point. The matter of labelling was worrying me last night, and perhaps Senator Phillips (Rigaud) cleared it up a bit. As I understand it now, the labelling can be sewn on the garment, stamped on the garment, or it can be attached by a string. There are many ways of doing it. For instance, if the garment is placed in a polyethylene package which has the details marked on it, would that constitute proper labelling?

Hon. Mr. Basford: It will in certain circumstances. I am thinking of the shirt manufacturer who sells his shirts to a retailer in a container that is designed to be supplied to the consumer. He could, pursuant to the regulations, provide the information that is required to be provided on the container.

Senator Blois: I think the largest single item in this category would be men's athletic shirts and shorts which are today put up in cellophane packages. There is a label on the garment itself but usually it contains just the maker's name without all of these other details. The reason why I am asking this, Mr. Minister, is because some firms have telephoned me about it. One firm that called me has already ordered all of its packages, and it has in stock sufficient to last until the early part of 1971. If by any chance this bill should become law within 30 days or 60 days this firm would take a very heavy loss which, of course, it must pass on to the consumer. I am wondering whether they could be exempted from the provisions of this act until the packages are used up.

Hon. Mr. Basford: First of all, the act comes into effect by proclamation. Secondly, I would draw your attention to the transitional and coming into force provisions, which are contained in section 17 and which deal with articles that are received, or that are in transit, or have been advertised. We have this provision in other acts that we administer. There will be consultations with industry to discover what time they require to make the transition. The act will come into force, and then the regulations passed under it will come into force at a later date.

Senator Blois: In other words, what you are saying is that people who have a year's supply of labels on hand will be exempted until such time as those are used up?

Hon. Mr. Basford: No, they would not be exempted. The regulations simply would not come into force for six months or a year, or whatever time is necessary, after the coming into force of the act.

Senator Blois: You will agree that some firms will be willing to have it come into force in three months, but others will want a year?

Hon. Mr. Basford: This is why we have to allow rather long periods before they come into force, but the granting of individual exemptions to firms has certainly proved during the long history of the Food and Drugs Act to be not the most suitable way of dealing with the matter. They would rather have a period before the regulations become effective.

Senator Blois: I do not want to appear to be forcing the issue, but one large firm asked me about this. If they call me tomorrow will I be able to say that the probability is that they will be able to use up the ten years' or one years' supply that they have on hand.

Hon. Mr. Basford: If they have ten years' supply on hand then I do not think. . .

Senator Blois: No, I agree that that would be unreasonable.

Hon. Mr. Basford: I think they should communicate directly with my department, or through their trade association, and let us know what their problems are and what length of time they require to dispose of existing labels. To set up a system of exempting individual firms would involve us in paper work up to our ears.

Senator Blois: Yes, I realize that.

Hon. Mr. Basford: And we do make some attempt to avoid paper work.

Senator Blois: I think I am clear now. They can use any one of the forms they now use, including the package or the attached ticket. The label does not have to be sewn onto the garment.

The Chairman: Senator, that is inherent in the definition of "label".

Senator Blois: Yes, I thought it was, but I was just checking.

Hon. Mr. Basford: Section 11(2) provides that a container may be deemed to be a label as required under the act.

Senator Everett: Is the manufacturer prohibited from using the trade name so long as he uses the generic name as required by the act?

Hon. Mr. Basford: No, there is nothing in this to prevent him using his trade name. Some, of course, have a very big investment in their trade name and they will be allowed to use it just as now. However, if someone has a trade name for a particular nylon product they will have to show that it is nylon, but they can use their trade name also.

Senator Everett: What happens under section 4, the prohibition respecting advertising? If he uses the trade name in his advertisement does he also have to give the fibre content? I do not know whether Viyella, for example, is a trade name. I know nothing about the industry. Assuming it was, would he advertise a Viyella shirt and then give the fibre content?

Hon. Mr. Basford: Yes; what is Viyella?

Senator Blois: Partly wool, a large proportion of it.

Senator Everett: So he would have to put that under the advertisement.

Senator Beaubien: Are yarns that catch fire easily going to be mentioned?

Hon. Mr. Basford: No, except of course there will be labelling of some of the textiles which are quite flammable. The flammability of fabrics will be dealt with, if we can deal with it at all, under the Hazardous Products Act. As I explained last year in this committee, it is a somewhat technical matter to draw the proper test standard for the flammability of fabrics. The National Research Council last fall developed a new test method, which is now being tested as to its suitability. If it proves practical we will be using that as a test method under the Hazardous Products Act. This legislation only deals with the labelling and advertising of textiles and would not require labelling if they are flammable.

Senator Grosart: Mr. Basford, would this bill give the authority under order in council to insist that a label be affixed to the garment?

Hon. Mr. Basford: Yes, it could. We can make regulations as to what form the label should take and how it should be affixed. The regulation covering an overcoat or a suit will read "affixed to the garment," as labels already are. Some will be allowed, where it is the custom of the trade, to use the container as a label. For instance, men's handkerchiefs. The buyer wants to know as a consumer whether he is buying Irish linen handkerchiefs or cotton handkerchiefs, but you do not want a big label on your handkerchief. This would be done by a sticker.

Senator Grosart: From the point of view of the manufacturer, is it possible that he has the right under the act to insist that you do not have the authority to prescribe that any product under the act be labelled except in keeping with paragraph (c) of the Interpretation section would make the word "apply" possible of interpretation as "cause to accompany". If the manufacturer applies that definition throughout the act in sections where "apply" is used in connection with the word label, it seems that he could say wherever the word "apply" appears I am entitled to interpret it in this broad sense, as "cause to accompany" and therefore the minister does not have the power under the act to prescribe a narrower definition.

Hon. Mr. Basford: Except that section 6 provides:

> Each label containing a representation as to the textile fibre content of the consumer textile article to which it is applied shall
>
> (a) be applied to the article in such form and manner as may be prescribed; and
>
> (b) show, in such form and manner as may be prescribed...

Senator Grosart: Yes, but "apply" can mean, if I read the interpretation clause correctly, "cause to accompany". It does not mean what it means in ordinary English.

The Chairman: I am not sure, senator, that I agree with your interpretation.

Senator Grosart: I am not making an interpretation, but asking a question, Mr. Chairman. I am merely saying if the definition of "apply" can be "cause to accompany" and that particular definition can be "applied" (I am not punning here) to the act wherever the word "apply" appears in relation to a label.

The Chairman: Section 6(a) is consistent with the definition clause.

Senator Grosart: I think it is, but it would seem to me that "apply" can mean wherever it occurs in connection with the word label "cause to accompany".

Hon. Mr. Basford: We can prescribe a regulation under which the label is caused to accompany the consumer textile article.

Senator Grosart: It seems rather strange that the bill uses the word "affix" in section 5. The strange wording of this clause perhaps indicates the confusion surrounding this point because, I suggest to you, section 5 is made meaningless in this context because there is no object to the verb "affix". I have read it a great many times and found it absolutely impossible to make this an English sentence.

Hon. Mr. Basford: I am not sure I understood that. I do not see your difficulty with section 5.

Senator Grosart: My difficulty, if I may Mr. Minister, is this: "No dealer shall affix—." What does he affix? I suggest it would be easier to read if we inserted a bracket: "(nor shall he sell, import into Canada or advertise a consumer textile article that has applied to it)" end your bracket there and where is the object of the verb affix?

The Chairman: In section 5 you have an article that has a label. That label may be applied in accordance with the statute but if in addition there is anything affixed which contains false or misleading information there is a prohibition aganst it.

Senator Grosart: I agree with the intent of it.

The Chairman: There are two different words "affix" and "apply", which have two different meanings in that clause.

Senator Grosart: A transitive verb must have an object, and what was intended...

The Chairman: You mean a person must have an object.

Senator Grosart: The verb must have an object.

The Chairman: Not necessarily.

Senator Grosart: I am trying to be helpful, because I do not think this clause makes any sense. I suggest to you that what is meant is this, if I may read it:

> No dealer shall affix to a consumer textile article (or sell, import into Canada or advertise a consumer textile article that has applied to it a label) a label that contains...

The draftman's problem is that he has to use "a label" twice. He has taken it out the second time, or somebody has, and there is now a sentence that is not English.

Senator Cook: I think the honourable senator is right as far as I can see.

Hon. Mr. Basford: My departmental counsel advises me that you are right, Senator Grosart, that the word "affix" should be "apply".

Senator Grosart: I said I was trying to be helpful. Perhaps some consideration might also be given to this further point. I am not an expert on the interpretation of statutes, but it seems to me that when this very wide meaning is available under the interpretation section there should be a time limit to this power of prescription. I say no more than that.

Hon. Mr. Basford: We think the way the Department of Justice has drafted section 6 covers your point.

Senator Grosart: It is a technical one, and perhaps I should not pursue it now because I could go through sections 3, 5, 6, 11 and 15, where the word "applied" is used in connection with a label. It is not till we get to section 15(2) that the draftsman has discovered his ultimate point of confusion, where he finally makes a distinction between "affixing" to the article and "applied" to a container. However, it is probably only a detail of drafting and I will not pursue it.

Hon. Mr. Basford: Containers are also dealt with in section 11(2).

Senator Carter: Section 5(3)(c) deals with misleading representation and relates to the performance of the article. Some articles are advertised as unshrinkable, perma-press and non-run silk stockings. Very often the extent to which a garment is unshrinkable is conditional upon how it is cleaned; when it is cleaned in cold water there is a different result from when it is cleaned in hot water. Does the manufacturer have to include in the label the conditions under which the performance can be achieved?

Hon. Mr. Basford: No performance claims can be false or misleading. What is aimed at under paragraph (c) is, for example, the labelling of garments made of re-processed or used wool as virgin or new wool; or, as you mention, labelling a garment as 100 per cent shrinkproof, and yet it shrinks; or machine knitted garments described on the label as hand knitted, which relates to the method of manufacture. In the example you give it would be for the judge to determine whether the claim on the label was misleading. For example, I would say a shirt described as absolutely shrinkproof would be assumed to be shrinkproof by the ordinary method of washing shirts, the commonly accepted method.

Senator Carter: That would be assumed. Of course, the shirt might be unshrinkable if it was dry cleaned or washed in water at a certain temperature, but how is the purchaser to know that?

The Chairman: It depends on the representation made by the manufacturer. As the minister says, it may be described as absolutely unshrinkable.

Senator Carter: Unshrinkable under all conditions?

The Chairman: Yes.

Hon. Mr. Basford: To take a hypothetical case, if something labelled as unshrinkable is unshrinkable only if dry cleaned or laundered by some exotic process that nobody knows about, and it shrinks when cleaned by the commonly used method for textiles or garments, I think any magistrate would regard that as misleading, because obviously it is a representation directed to what the reasonable person is going to understand by that statement.

Senator Blois: I should like to ask the minister a question I mentioned in the debate yesterday evening. Last Saturday I was telephoned by a tailor, who labels the suits he makes, who wanted to know whether he would have to put on the label the various components of the material, and also whether he has to include the lining of the suit in the total weight of the garment. The linings of the pockets could be nylon, cotton or many

blends. What does he have to do? At the moment he merely puts on the name and nothing else. Must he now show on the label everything that is in the suit, and how does he arrive at the weight percentage?

Mr. G. F. Osbaldeston, Assistant Deputy Minister, Department of Consumer and Corporate Affairs: The regulations are not written, but the intent would be that such things as pocket linings and buttons, which Senator Phillips (Rigaud) mentioned yesterday evening, would be excluded by the regulations. On the other hand, with a garment having an interlining for the purpose of warmth, and advertised as a garment having a special interlining that increased the warmth of the garment, it might very well be that the regulations would call for disclosure of the interlining purporting to increase the warmth of the garment.

Senator Blois: I was coming to that a little later. On Friday of last week a manufacturer showed me jackets and pants quilted with material inside. As far as he knew, five different components were used, and he is wondering what he will have to do.

Mr. Osbaldeston: The act and regulations would apply only if the component was over five per cent of the textile content.

Senator Blois: It could very easily be. It could be over seven per cent. It could go either way.

Mr. Osbaldeston: In any case, linings for construction purposes, such as the stiffening in a collar, would be eliminated.

Senator Blois: That would not be the five per cent anyway.

Mr. Osbaldeston: The textile which is on the outer part would certainly have to be labelled. You start with a quilted garment, which I assume would be sold for purposes of warmth. Therefore, he would have to disclose its interlining which is there for the purpose of warmth.

Senator Blois: I have one other question. I will go back to knitting yarns. There are a lot of small mills throughout Canada which are still making hand knitting yarns pretty much all wool. It has been sold amongst the lower priced knitting yarns. A tremendous amount was sold because some people cannot afford the others. It is used for mittens for children, socks and things of that nature. The point is, does every skein of that yarn have to be labelled and marked in some way? For instance, the man who was talking to me puts his yarn up in six-pound bundles, 24 skeins to a bundle. He was telling about another man who puts it up in fifths, which would be 30. At the present time there would be no objection to marking on the outside label of that six-pound package, but it would be quite extensive to mark and put a label or sticker on every bit of yarn. This could become quite serious.

Mr. Osbaldeston: Senator, if you are thinking of the length of yarn which ordinarily comes bundled, then we would be talking about regulations requiring labelling on the tie or the little bind which might go around a bundle having been sold to the consumer.

Senator Blois: I am unable to hear you.

Mr. Osbaldeston: Whatever product is finally sold to the consumer it must be labelled, with certain exceptions—if I may give exceptions. If it were the common practice for the manufacture to sell to the retailer a group of products inside a single box and then the practice was for the retailer to sell a piece of what he receives, such as perhaps a bolt of cloth, the best example then is that the bolt of cloth must be labelled and so must be the piece that is sold. He must give to the consumer an indication of precisely what he is buying. The principle, senator is that the labelling must be with the article until the sale is made.

Senator Blois: May I come back to this subject of the yarn. Labelling yarn, say 30 skeins to a package of low-priced yarn, is going to cost a considerable amount. A girl would have to label by hand each individual skein. I would like to know approximately whit it would cost—an increase of one cent per skein? It might not sound sike much, but a family buying 20 or 30 skeins during the winter is quite a lot.

Mr. Oabaldeston: I will clarify one other point. The consumer textile article has to be prescribed by regulations. In the act the ability to exclude certain textile products, which common sense would dictate, should be excluded. I might suggest something such as a shoe lace, but obviously one would have to make some judgment as to whether any benefit would derive from labelling a shoe lace. The first point that I make is the possibility of exclusion, after consultation with industry,

to ensure that we are labelling textile products that only make some meaningful contribution to the consumers' knowledge that there is some purpose in labelling.

Senator Blois: You are suggesting that this yarn I refer to might be exempt?

Mr. Osbaldeston: I would suggest that we would consider that if, after consultation with industry, we were able to understand their labelling problem.

Senator Blois: It is quite important and it should be considered.

There is one other question which I would like to ask. We spoke of this last night; it has to do with inspectors. The point I would like to find out is where are we going to do the inspecting? Are we going into the retail stores or the factories? It appears from the act that the inspectors can go any place. There are tens of thousands of small stores and large ones across Canada that sell goods that have a certain amount of textile fabric connected with them in one way or another. I would appreciate a clarification regarding this.

Mr. Osabldeston: Mr. Chairman, we presently have retail inspection service in the department. We have approximately 470 inspectors in 27 cities across Canada. In addition to that we have inspectors presently at the border points or the customs houses. So, in effect, we have inspectors stationed across Canada who can carry out the provisions of this act in terms of manpower. In terms of where they inspect, as I mentioned, we have inspectors at the customs points and secondly, some of our inspectors, for the purpose of checking, weighing and measuring devices, are already visiting certain factories. Thirdly, their daily task is to visit retail shops.

We do not envisage, if I may say so, the implementation of this act in adding to our present retail inspection services.

Senator Blois: Thousands of stores would not be checked at all, I assume.

Mr. Osbaldeston: That is true, sir, but I think relative to the total production we will be able to cover a fair percentage.

Senator Blois: The imports are pretty well taken care of now. I was thinking about the goods actually made in Canada which perhaps interests more Canadians than imports do.

Mr. Osbaldeston: We anticipate some assistance from the various people in the industry in locating imperfectly marked garments.

Senator Blois: Frankly, I think Canadian goods are pretty honestly marked now, but I wondered what you were going to do in connection with them. I have heard very few complaints about Canadian made goods. There have been a number of complaints on imported goods and I think this is going to cover that and that it is very necessary.

Mr. Osbaldeston: The fact is that the Canadian industrial textile industry in general, after consultation, support the concept of the bill.

Senator Blois: They do, and I tried to make that clear in the beginning, too.

Senator Carter: Does the department contemplate setting up, in their regulations, any criteria as to performance? For example, a waterproof garment may be labelled as waterproof and it may be showerproof, it may be waterproof under certain conditions but under other conditions it would not be waterproof. Have you agreed to set up any conditions so that the manufacturer can be sure when he labels a garment as waterproof that it meets the conditions required?

Hon. Mr. Basford: No, we are working on what we call a textile care labelling program, which is far advanced. It is a voluntary program. We have adopted the European system of care labelling, in which we use a symbolic system which could be easily understood by housewives and consumers. It is designed to be a voluntary program, simply to encourage manufacturers to affix the care labelling symbols to their garments.

Senator Blois: Might I ask one more question. Senator Isnor has asked me why the inspectors would go to retail stores when they could do it at the manufacturers' stores. I am asking that for my friend.

Hon. Mr. Basford: It has to include retailers because they might change the labels or lose the labels on the way through. The act must also apply to retail labelling.

Senator Blois: What you are saying is that perhaps they will go to both retailers and wholesalers?

Hon. Mr. Basford: The inspectors?

Senator Blois: Yes.

Hon. Mr. Basford: Yes.

The Chairman: Mr. Minister, perhaps you could clarify this point. When a seizure is made, you have to take some action within three months, unless the regulations in relation to that particular product provide for a longer period—or you must release or abandon the seizure.

Hon. Mr. Basford: Unless proceedings are taken.

The Chairman: Within three months. There is also a provision in the bill under which proceedings should be taken any time within a year. It becomes important, then, where the detention limit is three months, that you take proceedings within three months, because otherwise you give up the article and it may be you are throwing away some of the evidence. What is proposed to be done, if anything, in the regulation? What is the concept of granting a longer period than three months within which you must establish whether there has been a violation or not?

Senator Macnaughton: That is section 10(2).

Hon. Mr. Basford: The regulatory power was put in there to deal with the possibility that in certain cases there may be difficulties of analysis and we may need longer than 90 days to accomplish that.

The Chairman: All I was wondering is whether you would pass your regulation to meet the case or whether it would be generally in regulations defining different types of products where you would want a longer period than three months.

Hon. Mr. Basford: We would not pass regulations to deal with a specific case. It would apply to a general set of textiles.

The Chairman: But it would not be a general regulation that would come into force at the time you had a particular case and had made a seizure and the three months was about to run out?

Hon. Mr. Basford: No.

The Chairman: The provision would be in the general regulation?

Hon. Mr. Basford: Yes.

Senator Macnaughton: Section 10(2)(b) says:

(b) the expiration of ninety days from the day of seizure or such longer period as may be prescribed...

The Chairman: That is right.

Senator Macnaughton: It could be prescribed for ten years, if you wanted?

The Chairman: Except that there is another limiting factor, that they must take proceedings within a year.

Senator Macnaughton: All right. They could prescribe for eleven months and so many days

The Chairman: I would say one year, they would have to start their proceedings, in any event, within a year.

Senator Macnaughton: I am not trying to upset anything, I am trying to get some protection for the other side. There is such a thing as the rights of the manufacturer.

The Chairman: I can see that the longer you hold the goods, when you ultimately release them, without prosecution, they may be out of style and not very saleable.

Hon. Mr. Basford: That is there solely to deal with the problem of analysis, in the event that we have difficult problems of analysis which require longer than ninety days.

The Chairman: Are you ready to go through the bill section by section?

Hon. Senators: Agreed.

The Chairman: The definition section, section 2. There is an amendment I believe which you are proposing, Mr. Minister?

Hon. Mr. Basford: I believe Senator Phillips will move that it be amended by striking out lines 2, 3 and 4 on page 2 and by substituting therefor the following:

> be sold to any person for consumption or use other than consumption or use in the manufacturing process or finishing of any product for sale.

The Chairman: It is part of your definition of "consumer textile article"?

Hon. Mr. Basford: Yes. It would now read:

> (d) "consumer textile article" means
> (i) any textile fibre, yarn or fabric, or
> (ii) any product made in whole or in part from a textile fibre yarn or fabric that is in the form in which it is or is to be sold to any person for consumption or use other than consumption or use in the manufacturing process or finishing of any product for sale;

The Chairman: You so move, Senator Phillips?

Senator Phillips (Rigaud): Yes.

The Chairman: Are honourable senators in favour?

Hon. Senators: Agreed.

The Chairman: Section 2 of the bill, as amended at the top of page 2, in accordance with the motion which has been made?

Hon. Senators: Carried.

The Chairman: Section 3, dealing with prohibitions. Shall section 3 carry? Are there any particular questions on this? If not, shall it carry?

Hon. Senators: Carried.

The Chairman: Section 4. This is a prohibition in connection with advertising.

Hon. Senators: Carried.

The Chairman: Section 5(1) is one that we have been discussing earlier and in connection with a point which Senator Grosart raised. The minister, on conferring with his assistant, had indicated agreement with the position which Senator Grosart took at the time. I rather suggested that I did not think it was necessary to go so far as to contemplate an amendment. May I explain why? Section 5, subsection (1) says:

> No dealer shall affix to a consumer textile article or sell, import into Canada or advertise a consumer textile article that has applied to it a label that contains any false or misleading representation relating to or that may reasonably be regarded as relating to the article.

Now if that subsection were to stand alone, I would be inclined to agree that an amendment would be necessary to clarify the situation. But then when I go to subsection (2), I find it deals with a situation where the misleading information is on the label, and therefore if I am to give any sense to subsection (1), it must mean where I attach something in addition to the label.

Senator Grosart: There is no doubt, Mr. Chairman, that you can find out what it means if you look somewhere else in the legislation. But all I am suggesting here is that it be written in English.

The Chairman: It seems to be written in English to me.

Senator Grosart: But it is not in English when you have the verb "affix" without an object. There is a very simple amendment that would serve the purpose if, after the word "label" in line 4 there be added the two words "a label".

Hon. Mr. Basford: I am advised by Counsel that it might be better to change the word "affix" in the first line of subsection (1) to the word "apply" so that the section will then read:

> No dealer shall apply to a consumer textile article or sell, import into Canada or advertise a consumer textile article that has applied to it a label that contains any false or misleading representation relating to or that may reasonably be regarded as relating to the article.

The Chairman: Are you proposing to strike out subsection (2)?

Hon. Mr. Basford: No.

The Chairman: Because then you are giving the same purpose and intent to both clauses.

Senator Grosart: There are two different prohibitions in subsections (1) and (2).

Hon. Mr. Basford: Subsection (2) relates to false labelling of textile fibre products which may not be consumer textile articles.

Senator Grosart: I am simply suggesting, Mr. Minister, that if you change the very "affix" to the verb "apply" you still have not improved the situation from the point of good English structure. Assuming that in line 2 starting with the words "or sell" you insert parenthesis or brackets and you continue the parenthesis down to the words "a label" in the fourth line, then if you do not add the additional phrase "a label" it will read that no dealer can affix to a consumer textile article, without saying what he cannot affix to that article, that contains any false or misleading information.

Hon. Mr. Basford: I would agree that the construction should be that "no dealer shall apply to a consumer textile article—"which is one prohibition—"or sell or import into Canada or advertise a consumer textile article that has applied to it a label that contains" etcetera—the prohibition there is that you shall not apply to consumer textile article or

sell, import into Canada or advertise a consumer textile article that has applied to it a label.

Senator Grosart: I do not wish to labour the point, but I know that many honourable senators agree with me that if somebody sits down to examine the structure of this particular subsection, he will find that there has to be an object of the verb "apply" or else this is not a sentence in English.

Hon. Mr. Basford: Well, I will ask Miss Lozinski.

Miss O. C. Lozinski, Legal Adviser, Department of Consumer and Corporate Affairs: The construction was intended to have "a label" as the object of the verb "apply" and then goes on "to a consumer textile article," and is also related to "that has applied to it a label".

Senator Grosart: But it cannot be the object of the verb in the main sentence and also the portion in parenthesis.

Senator Hollett: Could we not overcome this difficulty by changing the first line to "no dealer shall affix a label" etcetera?

The Chairman: Or "shall apply a label". That was the suggestion of our law clerk—"No dealer shall apply a label to a consumer article or sell, import into Canada. . ." and so on.

Senator Grosart: Another test is to insert parenthesis beginning with the words "or sell" by taking your pencil and putting a bracket before the word "or" in line 2 and a bracket after the word "label" in line 4 which gives you a parenthesis in the middle of the sentence and if the remaining sentence is to make sense there must be an object to the verb. If not, it will read as follows:

> No dealer shall affix to a consumer textile article. . .that contains any false or misleading representation relating to or that may reasonably be regarded as relating to the article.

As you can see, there is no object to the verb there.

Senator Hollett: Well, Mr. Chairman, as I have said, why not put in "No dealer shall affix a label" and then continue on?

The Chairman: I understand the point that is being made and I suppose there is no need to repeat it again.

Senator Leonard: It seems necessary to repeat it many times.

The Chairman: Well, we all know what he is saying, but whether we agree with what he is saying is a different matter.

Senator Cook: Why not make it two subparagraphs?

The Chairman: Well, we will wait for the department to indicate what it is proposing.

Senator Leonard: Let us go on with the rest of it and come back to that.

The Chairman: While you are debating this matter, Mr. Minister, we will go on, letting section 5 stand for the moment.

Shall section 6 carry?

Hon. Senators: Carried.

The Chairman: Section 7 deals with analysts. Shall it carry?

Hon. Senators: Carried.

The Chairman: Then we come to section 8 dealing with search and seizure provisions. Shall section 8 carry?

Hon. Senators: Carried.

The Chairman: Section 9 deals with obstruction of inspectors. Shall section 9 carry?

Hon. Senators: Carried.

The Chairman: Section 10 deals with seizure. Shall section 10 carry?

Hon. Senators: Carried.

The Chairman: And section 11 deals with authority to make regulations and prescribing the subject matter of regulations. Shall section 11 carry?

Hon. Senators: Carried.

The Chairman: Section 12 deals with offence and punishment. Shall section 12 carry?

Hon. Senators: Carried.

The Chairman: Section 13 dealing with offence by employee or agent—shall section 13 carry?

Hon. Senators: Carried.

The Chairman: Then we come to section 14 dealing with the certificate of analyst. Shall this section carry?

Hon. Senators: Carried.

The Chairman: Section 15 deals with identification in labels. Shall this section carry?

Hon. Senators: Carried.

The Chairman: Section 16 on forfeiture.

Senator Kinley: Section 16(2) reads:

> The provisions of section 64A of the Fisheries Act apply with such modifications as the circumstances require to any textile fibre product or other thing forfeited under this section as though that textile fibre product or other thing were an article forfeited under subsection (5) of section 64 of that Act.

It says here:

> ... with such modifications as the circumstances require...

What is the significance of that?

Senator Phillips (Rigaud): I thought I explained that in explaining the bill.

Senator Kinley: Yes, I read that.

Senator Phillips (Rigaud): Obviously, that is dealing with the forfeiture of a ship under The Shipping Act. The protection of the creditor or innocent owner of goods seized would obviously have to have wording different from the wording that would apply to the ship, because the nature of the interest of the creditor or owner in relationship to the ship would be different from that of the owner or creditor whose interest was in relationship to the textile product.

Senator Kinley: If there is a ship and you have a mortgage or a lien, the difficulty is that he may have a $5,000 interest in it.

Senator Phillips (Rigaud): The fundamental point is to protect innocent owners or creditors in respect of the seized or detained articles, provided such owner or creditor establishes his position as owner or creditor judicially.

Senator Kinley: This act contracts the people out of the Combines Act? People coming under this act are not subject to the Combines Act?

Hon. Mr. Basford: The Combines Act does not enter into it.

Senator Kinley: They can come under the Combines Act in the case of a prosecution, can they?

Hon. Mr. Basford: No.

The Chairman: That is a different offence. There is an offence created here and a punishment and a procedure. You do not go anywhere else for it. You may go to the Fisheries Act to find out how certain rights are protected. The Combines Act is an entirely different thing.

Senator Kinley: You do not set out in this act that you contract out of the Combines Act?

Hon. Mr. Basford: No, there is no reference in here to the Combines Act, and this has no relevance to the Combines Act.

Senator Kinley: There is an amendment in the Combines Act which was not in the Combines Act originally.

The Chairman: Shall section 17 carry, which deals with the transitional period, which we discussed earlier?

Hon. Senators: Carried.

The Chairman: Section 18?

Hon. Senators: Carried.

The Chairman: Shall we now revert to section 5?

Hon. Mr. Basford: They are having a conference in the back row to get an amendment satisfactory to Senator Grosart.

The Chairman: The amendment has to be one that is satisfactory to the committee!

Senator Phillips (Rigaud): Perhaps we could speak holus bolus on the White Paper in committee while we are waiting.

The Chairman: We have another bill to deal with first.

Senator Hays: Mr. Chairman, are you convinced the way the bill is now presented that it is right?

The Chairman: Our Law Clerk has suggested something. I do not know whether it has been accepted or not.

Hon. Mr. Basford: I am advised that we could amend it to read:

> No dealer shall
>
> (a) apply to a consumer textile article, or

(b) sell, import into Canada or advertise a consumer textile article that has applied to it...

Senator Grosart: There is your difficulty right there.

Hon. Mr. Basford:

...a label that contains...

I am advised by counsel that would clear up the matter.

Senator Grosart: It is simply a lack of understanding of English syntax. The very fact you hesitated, Mr. Minister, at that point indicates exactly the point I am raising.

Hon. Mr. Basford: No, I was trying to determine which was your writing and which was Miss Lozinski's.

Senator Grosart: I think you were trying at that point, as the draftsman is doing, to make this word "label" work both in the main sentence and in the parentheses.

It is very simple to change. If you will merely put the word "label" at the end of subclause (b) and a comma, and then start again, "a label...".

The Chairman: We do not have a subclause (b).

Senator Grosart: We have it in the draft. The Minister was reading from the draft.

The Chairman: What is the objection to putting in the words "a label" right after the word "affix" and to change "affix" to "apply"? This is what our Law Clerk suggests.

Senator Grosart: The whole of the last sentence would then read:

> No dealer shall apply a label to a consumer textile article or sell, import into Canada or advertise a consumer textile article that has applied to it a label that contains any false or misleading representation...

...and so on.

Senator Giguère: The French version is very clear. Why do you not translate it?

The Chairman: Will you translate it?

Senator Grosart: That is quite true, the French is quite clear.

Senator Leonard: The word "label" is in twice in the French version, and that is the correct meaning.

Senator Grosart: Put "label" in twice in the English version.

Senator Leonard: Actually the translation would read:

> No dealer shall affix to a consumer textile article a label that contains any false or misleading information or which could be reasonably considered as relating to the label, nor sell or import into Canada such article which bears such label, nor advertise such article.

The word "label" should appear twice.

Senator Grosart: If it would help matters, Mr. Chairman, I am through and I give up!

The Chairman: The suggestion which the minister has now made...

Hon. Mr. Basford: It was Senator Leonard's suggestion.

The Chairman: Then following what Senator Leonard has said, section 5 should be changed to read:

> No dealer shall apply to a consumer textile article a label, or sell, import into Canada or advertise a consumer textile article that has applied to it a label...

Senator Leonard: Yes, and it goes on: "if such label", or "where such label".

The Chairman: It continues: "that contains any false or misleading representation..." et cetera.

Senator Leonard: Yes.

The Chairman: Is the committee prepared to accept that amendment?

Hon. Senators: Agreed.

The Chairman: Is the title carried?

Hon. Senators: Agreed.

The Chairman: Shall I report the bill as amended?

Hon. Senators: Agreed.

The Chairman: We have now before us for consideration Bill C-9, to amend the Small Businesses Loans Act. Mr. Renwick, from the Department of Finance, is present to explain

the bill. Mr. Renwick, would you tell us the purpose of this amending bill?

Mr. J. A. Renwick, Government Finance and Capital Markets Division, Department of Finance: Mr. Chairman, the lending period in the Small Businesses Loans Act expired on December 31, 1969, and in order to continue the act in force one of the clauses of this bill provides an additional lending period that will expire on June 30, 1971. The reason for selecting a period of a year and a half, rather than the normal three years, was because the lending period under this act will now expire at the same time as that under the Farm Improvement Loans Act and the Fisheries Improvement Loans Act, which are the other two guaranteed loans programs operated through the chartered banks and other financial institutions.

Other amendments in this bill are similar to those that have been made previously to the Farm Improvement Loans Act and the Fisheries Improvement Loans Act. This is the reason for the addition of trust companies, insurance companies, loan companies, credit unions, and co-operative credit societies as lenders under the act. I believe that is the only substantive addition to the legislation that is contained in this bill.

The Chairman: You have not increased the lending limits?

Mr. Renwick: I was going to comment on that. In addition to the new lending period it was necessary to add a new loan pool, or a new maximum aggregate amount of loans subject to the guarantee of the Minister of Finance. In addition, since provision is made for the addition of new classes of lenders, the liability of the minister to an individual small volume lender has been substantially increased.

The Chairman: Are there any questions?

Senator Phillips (Prince): Mr. Chairman, the minister without portfolio, when he introduced the bill in the other place, stated that presently the practice amounted to a 100 per cent guarantee, and he then went on to state that this amendment will guarantee 90 per cent of the aggregate value of the first $125,000, and then 50 per cent of the next $125,000, and 10 per cent in excess of $50,000. From looking at the annual reports it seems to me that the amount of money loaned by the chartered banks, at a time when they had, in effect, a guarantee of 100 per cent, was decreasing. I am rather curious—perhaps "baffled" is a better word—as to the reason for the amendment. I am referring to the guarantees of 90 per cent, 50 per cent, and 10 per cent of the aggregate principal amount.

Mr. Renwick: Credit unions may now make loans under this legislation. If we were to leave in only the overall 10 per cent of the aggregate value of the loan made by the lender, this would mean that if a credit union made only one loan of $25,000 the liability of the minister to that credit union would be 10 per cent of that amount. In the event of default on that one loan the credit union would be able to recover only $2,500. Under the new 90 per cent provision, the minister's liability would be $22,500.

Senator Benidickson: You are talking in terms of $25,000, which is the maximum amount of loan under the act, but I do not think I or anybody else brought out in the debate in the Senate the other night the fact that the average loan is about $10,000. We must be realistic about what the average amount of loan is.

The Chairman: This was just an example.

Mr. Renwick: Yes. The same conditions exist in respect of a loan of $1,000, where the credit union's cover would have been $100.

Senator Phillips (Prince): I am still confused as to why there is a need for this amendment, because it seems to me that you are taking away the effect of a 100 per cent guarantee from the chartered banks and the credit unions. Would it not have been better to separate the two of them?

Mr. Renwick: Well, the situation will change very little in the case of the chartered banks, because generally the chartered banks have a very high volume of loans. For an institution that would make a million dollars worth of loans the liability of the minister would not increase very much because only the first $125,000 of the loans they made would be subject to a 90 per cent guarantee; the second $125,000 is subject to a 50 per cent guarantee; and with respect to anything over that the old 10 per cent provision will continue to apply.

Senator Phillips (Prince): What constitutes a credit union under this act? For instance, certain of the provinces are now bringing all the small branch credit unions under one

organization. Is each individual branch covered for $125,000 or does this apply to the whole of the credit unions in the province?

Mr. Renwick: It would be up to each individual credit union to make application to the minister. They would be treated as a separate lending institution for purposes of the legislation. In the case of chartered banks it is the bank and not the individual branch that is considered as the lending institution.

Senator Benidickson: Senator Phillips (Prince) referred to the reduction in the volume of loans under the existing act. I am sure he arrives at that, as I would have, based on the last available annual report, which is 1968, but by order in council the rate of interest available to the lender, which up to now has been solely the chartered banks, was increased. Could the witness tell us something about the volume of lending in 1969?

Mr. Renwick: The volume of lending has picked up considerably over what had been the case in 1968. Our data goes only to about the end of October. It would appear that $15 million to $16 million may be the final total volume of loans made under the legislation in the current year, so it is somewhat of an increase.

Senator Benidickson: In some years though it has reached $26 million.

Mr. Renwick: That is correct, particularly in the early years and immediately prior to 1968 $20 million was a more representative figure. It has not quite returned to what could be considered to be previous levels yet.

Senator Phillips (Rigaud): With respect to section 3, clause 4 regarding the limitation not to exceed $100 million in one instance and $50 million in the other, are the banks advised of the danger of reaching the ceiling on a monthly basis?

Mr. Renwick: We have never run across the situation where we have come close in any of the guaranteed loan programs to reaching this aggregate figure. Presumably if we were to approach it we would make this information available immediately, probably to both the Canadian Bankers' Association and to the head offices of the banks, well in advance.

Senator Phillips (Rigaud): Would it not be desirable to work out a clear-cut administrative procedure under this act in terms of advice and policy directives given to bank managers across the country so that the banks would know generally when they are reaching the danger point? This goes to the enforcement of the statute.

Mr. Renwick: We would know well in advance if we were approaching $100 million over the next year and a half. As soon as it appeared that there might be a possibility of this happening we would inform the chartered banks.

Senator Phillips (Rigaud): There could be a danger in going from coast to coast. I know the banking system generally is most anxious to look after these small loans. The local managers are encouraged to see that this is done. Therefore there ought to be a signal warning if you are reaching the ceiling.

Senator Burchill: What is the situation at the moment?

Mr. Renwick: In the lending period which expired at the end of last year $300 million had been the limit for the three year period from January 1, 1967 to January 1, 1970. Only roughly $100 million of that had been used. As you can see, there was considerable latitude. It was more than twice the amount needed.

Senator Benidickson: What advertising of these rather worthwhile small businesses loans is provided by government, banks or lenders?

Mr. Renwick: Our department makes a distribution of brochures to the banks. Depending on the individual branch, the degree of display varies. I have seen these brochures in racks at branches of Ottawa banks. We issue a quarterly press release indicating the volume of loans made during the previous three months, which receives a small amount of press coverage. We receive numerous inquiries from people wanting to start businesses and borrow money. They are made aware of this program if it appears applicable to them.

Senator Benidickson: What is your relationship to the I.D.B.? You are limited to $25,000. Does that not encompass opportunities of the I.D.B.?

Mr. Renwick: There is no formal relationship between the Small Businesses Loans Act and the I.D.B. There would be a certain

amount of overlap certainly on the size of the loan available. This would be a matter of preference on the part of the borrower. If we were unsuccessful in obtaining a loan from a bank he might turn to the Industrial Development Bank. This is done on his initiative.

The Chairman: Shall I report the bill without amendment?

Hon. Senators: Carried.

The committee proceeded to the next order of business.

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1969-70

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE
ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 10

WEDNESDAY, MARCH 4th, 1970

Fifth Proceedings on the Government White Paper, entitled:
"PROPOSALS FOR TAX REFORM"

WITNESSES:

Investors Group: Clarence E. Atchison, President and Chief Executive Officer; Robert H. Jones, Executive Vice-President. *Investors Syndicate:* James N. W. Budd, President; Wayne S. Walker, Manager, Tax Services. *Western Savings & Loan Association:* Andrew F. Jackson, President. *Canadian Realties Fund for Quebec:* H. Heward Stikeman, Counsel; E. Schousboe, Manager.

APPENDICES:

"A"—Brief from Investors Group.

"B"—Analysis of Appendix 'A' by Senior Advisor.

"C"—Brief from Canadian Realties Fund for Quebec Limited.

"D"—Analysis of Appendix 'C' by Senior Advisor.

"E"—Special Study No. 4—Grossing-Up of Canadian Dividends.

THE STANDING SENATE COMMITTEE ON

BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aseltine	Desruisseaux	Kinley
Beaubien	Everett	Lang
Benidickson	Gélinas	Leonard
Blois	Giguère	Macnaughton
Burchill	Grosart	Molson
Carter	Haig	Phillips (*Rigaud*)
Choquette	Hayden	Walker
Connolly (*Ottawa West*)	Hays	Welch
Cook	Hollett	White
Croll	Isnor	Willis—(30)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

"With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intituled: "Proposals for Tax Reform", prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

"With leave of the Senate,

The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Hayden:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

21634—1½

MINUTES OF PROCEEDINGS

WEDNESDAY, March 4th, 1970.
(13)

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to further consider:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Hayden (*Chairman*), Beaubien, Benidickson, Blois, Burchill, Carter, Connolly (*Ottawa West*), Cook, Everett, Gelinas, Giguere, Haig, Isnor, Kinley, Lang, Leonard, Macnaughton, Phillips (*Rigaud*), Welch and Willis—(20).

Present, but not of the Committee: The Honourable Senators Argue, Cameron, Laird, McLean and Sullivan—(5).

In attendance: Arthur W. Gilmour, Senior Advisor; Alan J. Irving, Legal Advisor; R. Breton, Executive-Secretary.

Mr. Gilmour presented Special Study No. 4 with a short explanation thereof and it was agreed that at the meeting of Wednesday next a further discussion would take place on the above Study.

The following witnesses were heard:

Investors Group:

Clarence E. Atchison, President and Chief Executive Officer;
Robert H. Jones, Executive Vice-President.

Investors Syndicate:

James N. W. Budd, President;
Wayne S. Walker, Manager, Tax Services.

Western Savings & Loan Association:

Andrew F. Jackson, President.

Canadian Realties Fund For Quebec:

H. Heward Stikeman, Counsel;
E. Schousboe, Manager.

Ordered:—That the documents submitted at the meeting today be printed as appendices to these proceedings, as follows:

"A"—Brief from Investors Group.
"B"—Analysis of Appendix 'A' by Senior Advisor.
"C"—Brief from Canadian Realties Fund for Quebec Limited.
"D"—Analysis of Appendix 'C' by Senior Advisor.
"E"—Special Study No. 4—Grossing-Up of Canadian Dividends.

At 11:50 a.m. the Committee adjourned to the call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Wednesday, March 4, 1970.

The Standing Senate Committee on Banking, Trade and Commerce met this day at 9 a.m. to give further consideration to the White Paper entitled "Proposals for Tax Reform".

Senator Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: Honourable senators, we have two submissions today. The first one is from the Investors Group and, according to the information furnished to me, the appearances will be as follows: Mr. Clarence E. Atchison, President and Chief Executive Officer of the Investors Group; Mr. James N. W. Budd, President, Investors Syndicate Limited; Mr. Robert H. Jones, Executive Vice-President, Investors Group; Mr. Andrew F. Jackson, President, Western Savings and Loan Association; and Mr. Wayne S. Walker, Manager, Tax Services, Investors Syndicate Limited.

Before proceeding with their submission I should say that Mr. Gilmour is with us again, and I welcome him back. There are some papers in your possession on which he has not given you any explanation, and I think we should take four or five minutes at this time to let him explain what is the purpose and intent of the additional material you were given, quite apart from what relates to today's briefs.

Senator Connolly (Ottawa West): Mr. Chairman, before Mr. Gilmour starts I should like to make just one comment. We are getting a great deal of material, and certainly that which we are getting from Mr. Gilmour is very good but I am wondering how much of it we should continue to bring to these meetings. I do not know whether we should continue bringing a paper here after it has been dealt with by Mr. Gilmour. After a while we are going to have quite an accumulation of our own material quite apart from the material we receive from witnesses.

The Chairman: This material is provided to you so that you will be informed on the various subjects that are dealt with in the White Paper, and the supply of this material will be a continuing process. We have three or four studies under way now, and I have two or three others in mind that we should be doing, and which I am going to discuss today with Mr. Gilmour. The one that you now have dealing with small businesses was to have been dealt with at the last meeting when Mr. Gilmour was here, but we did not get around to it because we took up so much time with the questions on other subjects.

I think the answer to your question as to whether you should bring all the material into this room each time is that that is a judgment decision on your part. It will also require some physical effort.

Mr. Arthur Gilmour, Special Tax Adviser: May I say something on that, Mr. Chairman?

The Chairman: Mr. Gilmour may answer that question in the course of the statement he is about to make. Will you proceed, Mr. Gilmour?

Mr. Gilmour: Senator Connolly, to answer your question I will say that for each brief that is presented we intend to present a short position paper on it. As an example, this morning we have sought to prepare a position paper which gives a short summary of the major subject of the brief and, of course, a more detailed comparison of the laws. These papers, of course, are current, and are intended to be used on the particular day.

The special studies are really designed to bring out major aspects of the White Paper, and the results of them. I really do not think it is necessary that you bring them here every day. They are intended as background reading.

This morning, with your permission, I should like to place before you Special Study No. 4. This is the first instalment of the study that I was asked to make some weeks ago by

Senator Phillips (Rigaud) when we were dealing with this grossing up of Canadian dividends, which is a fundamental concept of the White Paper.

At one of our latter meetings I made the rather picturesque statement, if you like, that the grossing up of dividends was really a Victorian concept that was progressively abandoned by the country that, so far as I know, invented income tax, namely, Great Britain.

I have put in my first chapter of Special Study No. 4, and there will be additional chapters later on. In going into the background development of the grossing-up concept I came across a statement made by the British Chancellor of the Exchequer on April 6, 1965, when Great Britain finally abandoned its traditional concept of regarding corporation tax as a payment in advance on behalf of the shareholders. Effective with 1965, Great Britain adopted its present day tax system, in which it regarded corporation income tax completely separately from the individual income tax.

On pages 3, 4 and 5 of Special Study No. 4 I have included the statement made by the Chancellor of the Exchequer of Great Britain, and I have taken the liberty of underlining certain parts—not that his remarks needed my underlining, but there were certain phrases that are so apt to our study that I felt I should draw them particularly to your attention. At the bottom of page 3 there is this quotation:

> These changes have made obsolete the idea that companies and individuals should be treated for tax in the same way. By separating formally the two taxes, namely, the tax on corporations and the tax on individuals, we shall be bringing the tax system of the United Kingdom into line with reality and adopting what has become the general practice throughout the world.

He then quotes from the report of the British Royal Commission on Taxation in these words:

> We accept the necessity for the subjecting of company profits to a special tax regime that is something more than a mere attempt to collect personal income tax in advance.

And he carries on by pointing out that the adoption of the present Canadian system, in his mind, has certain advantages, and he says:

> The latter tax...

That is, corporation tax.

> ...in my view, has a much greater economic and incentive value than the former. A tax confined to undistributed profits penalises investment and growth; it severely handicaps the young and dynamic companies which may rely on ploughed-back profits for expansion.

I would stop there because the rest of his speech is self-evident. I would merely like to put this before you because I doubt if there are any tougher or more experienced tax officials in the world than the British Chancellors of the Exchequer.

It is quite striking, I think, that the British, faced with their vicious economic problems, have decided to break away from this old grossing up system. This appears to be one of the fundamental proposals of our White Paper, and I leave it to you gentlemen to draw your own conclusions.

Senator Phillips (Rigaud): Mr. Chairman, it was because I was familiar with the conclusions in Great Britain that I suggested to honourable senators that we ask our adviser to prepare this memorandum, which, I might say, is self-explanatory. We have an absurd situation with which, of course, tax lawyers were familiar, in which we are urging the introduction of a system which the U.K. authorities, who are the most sophisticated in the world, now think is archaic. The question is now raised as we are dealing with these briefs whether this interesting and very important report should now be buried with all the other material and to be dealt with in due course or should it be regarded as of sufficient importance to justify our working out some mechanical procedure pursuant to which the Minister of Finance is advised thereof as expeditiously as possible. We have not discussed the question of interim reports of this committee necessarily going to the Senate at large, or whether we are in a position to submit interim reports wherever we think necessary to the Government, that is to say the cabinet, or to the Minister of Finance.

In this connection what I am about to say is germane to the subject. This morning I handed you a copy of a very important speech by the honourable Edwin S. Cohen, Assistant Secretary to the Treasury for Tax

Policy in the United States. This was delivered before the session of the 56th National Foreign Trade Convention at New York City on November 19, 1969. I ask you to request honourable senators to concur in my view that we ask our adviser to study it and report on same. I think he will conclude that the United States is burdened by complications resulting from treatment of so-called offshore companies, or foreign subsidiaries and their domestic parents. They are considering the revision of the entire subject matter in the United States, and here one of their top experts refers to the mountainous accumulation of troubles that has arisen. I submit (a) that we should ask our adviser to deal with that subject matter; and (b), I suppose I should have made this (a), I am strongly in favour of considering the submission of this first report, Study No. 4, to the Minister of Finance or the Government immediately and publicizing it. The more one studies the paper the more it is apparent that it was conceived in equity and reared in ineptitude. I see more ineptitudes the more I study the paper. Therefore it is vitally important that this committee advise the Minister of Finance, not of our general reactions, because this is presumably a judicial body, but an important study of this nature should be drawn to the attention of the Government forthwith.

Senator Cook: I agree that the document should be made public, if nothing else.

Senator Macnaughton: A solution would be to make both this document and Senator Phillips' (Rigaud) submission part of the record.

The Chairman: Next week we have three briefs in respect of which we have given appointments. If that is all we are going to have next week, the sittings will not be very long. They all raise the same point, that is dealing with public utilities and the indication from the White Paper, or the absence of the necessary confirmation in the White Paper, as to the position of shareholders in public utility companies with regard to gaining tax credit. This is with respect to the federal statute passed in 1966 under which 95 per cent of the tax levied by the federal authority was transferred to the provinces. The White Paper suggests that the minister might make it 100 per cent. The only point at issue in the three briefs is whether the shareholders of those companies should be entitled to a tax credit, because the company is subject to corporate tax. It does seem an anomaly that it is then suggested that they are not going to receive tax credit. We will have time next week in which we could discuss Special Study No. 4, including the report of the speech made by Mr. Cohen and any additional information on this subject matter of grossing-up which Mr. Gilmour may bring forward in the meantime. Let us make a field day of it, instead of just filing it and saying this is public. The subject is so important that every phase of it should be discussed in this committee.

Senator Macnaughton: Two or three of us will be in Washington next week and therefore unable to be at the meeting. That applies to our super expert to my left.

Senator Phillips (Rigaud): Yes, we will not be here. All I would do next week would be to make observations even a little more incisive, if that were possible.

The Chairman: Yes, you mean stronger words than ineptitude?

Senator Phillips (Rigaud): Yes.

The Chairman: Well, they are strong enough to start with, senator.

Senator Isnor: The tax credit does not go to the companies but to the provinces.

The Chairman: That is true. The transfer of the corporate tax by the federal authority does not go to the public utility, but to the province. Alberta is the only province in Canada that gives it to the public utility. All the other provinces put it into their consolidated revenue fund and use it for general purposes.

Senator Isnor: Notwithstanding that the province itself has the power of remission.

The Chairman: We will discuss that next week. There is just one point of issue in the three briefs next week, so we will have time for that discussion. Is this a one day conference in Washington?

Senator Macnaughton: It is two days and we will be away Tuesday, Wednesday and Thursday.

The Chairman: We should prepare. This is very important and we would like to have you here, but we should leave it open to have these discussions.

There are points raised in the brief from the investors' group which we are going to consider now.

Senator Everett: Mr. Chairman, before we proceed to that brief, in criticizing the grossing-up system, is it implied that we are criticizing the concept of single taxation? If that is the case, then as next Wednesday I will be in Toronto with the Special Senate Committee on Poverty and unable to attend your meeting, I would like to disagree with any concept that says there should be no single taxation and moves us away from the concept of double taxation. Just looking at the Lord Chancellor's remarks it would seem to me that, while he makes a case against grossing-up, he makes a case for double taxation. Therefore I find myself in disagreement with Senator Phillips (Rigaud). The method used in the White Paper to achieve a single taxation system, that is grossing-up, may be wrong, but I certainly would not be in agreement with a recommendation that the concept itself of moving away from double taxation is wrong. I wish to have that clear on the record.

The Chairman: Do not let us become involved in a case of semantics. Grossing-up is an expression that has been used to describe what the White Paper proposes. Inherent in that there is a double taxation; that is, there is a tax on the company and a tax on the individual who receives dividends, and it is a matter of how the credits are granted. Under our present law there is a tax on the corporation and a tax on the individual who receives dividends, and then he gets a credit by way of deductiion from the tax that he would otherwise pay on his income. There is the element of double taxation in that, surely, but there is a credit. In the grossing up, there is the corporate tax and the individual tax, and there is a system of tax credits, but those are dependent on the amount of corporate tax paid.

Senator Everett: That is correct.

The Chairman: And on the amount of dividends declared.

Senator Everett: But in the case of closely held corporations, where the problem of double taxation creates the worst anomalies, this grossing up, whether you like it or not, cures that anomaly.

The Chairman: The present method of tax credits surely, you would have to agree, cured the anomaly.

Senator Everett: Indeed not. You mean the 20 per cent tax dividend?

The Chairman: Yes.

Senator Everett: Far from it for the closely held corporation that is building up a surplus. We will come to that in the Investors Group brief. I noticed that they make that point.

Mr. Gilmour: Chapter 2, which has not even been written yet as I am just back from the west coast, will, I think show that the grossing up system as applied to the closely held corporation, and particularly the proposals to commence the grossing up system as it applies to a closely held corporation, will take one more kick at the small businessman. In analyzing the White Paper as it applies to the small business, it almost seems to me that the authors seem determined to run the small businessman out of this country. I would like to demonstrate these statements by arithmetical examples, not the one-sided examples that appear in the White Paper but what I think are the practical every day examples of the small business, be he commercial or be he a manufacturing businessman in any city in Canada. There are many of these proposals that are terribly unfair, so that whilst I appreciate your views, none the less the practical application of this principle does not seem to work.

Senator Everett: I defer to Mr. Gilmour's astonishing knowledge on tax, but this seems to make the point that the case on grossing up and double taxation is not in yet, and I do not think the committee should make any move, either to publicize it or to notify the Minister of Finance or the Department of Finance of its position, until that case is in in full.

The Chairman: What do you think was my purpose in suggesting that we have a full discussion on the question?

Senator Everett: I am sure that was your purpose.

The Chairman: That was the purpose, yes.

I think we are now ready to go ahead with the first submission, by the Investors Group. Mr. Atchison, how will you proceed? Will you read your brief first?

Mr. Clarence E. Atchison, President and Chief Executive Officer, Investors Group: I have a summary here, and then I will proceed, if you wish, to the brief later.

The Chairman: Is that satisfactory, that we have a summary of the brief?

Hon. Senators: Agreed.

The Chairman: If you are more comfortable sitting down, please remain seated.

Mr. Atchison: Mr. Chairman, honourable senators, we are pleased to have been invited to submit our views to this committee on the matter of tax reform. The Investors Group acts on behalf of the 180,000 mutual funds investors and 130,000 investment certificate clients, and various pension fund clients. In total we are responsible for the management of assets in excess of $1.7 billion.

In our submission we have tried to make suggestions for improvements in the proposals for tax reform in order to eliminate inequities and administrative complications. Although we are the largest manager of mutual funds in Canada, we have not made any comments on their tax situation. The Canadian Mutual Fund Association, of which we are a member, will be presenting a brief on behalf of its members and the mutual fund investors. Our views will be contained in that brief.

Our main concern here today is for our investment certificate investment clients. We explain that the proposed changes will be retroactive for these people and will have adverse social effects for Canada. The majority of these clients are in low income brackets and have very little in the way of savings. While the revenue gain to the Government arising from the proposed change in taxation of certificate holders would be very small—we estimate under $2 million annually—the tax increases to the individuals are significant. We have estimated that they could lose a full year's savings through the proposed tax changes.

The second major topic that is of concern to us is the additional complication introduced for groups of associated corporations. The taxation of inter-company dividends, the taxation of previously accumulated surplus, the treatment of expenses connected with dividend income and capital gain, and the taxation of foreign income and the valuation of controlling interest in subsidiaries are discussed. The real issue in these proposals is the extent to which the normal business practice will be affected.

Thirdly, we recommend that the proposed rule for valuation at valuation day should be revised to provide greater equity. We believe that a gain subsequent to valuation day should be taxed only to the extent that it is actually a gain. A system that taxes the recovery of losses which are not deductible from income is not equitable, and can lead only to widespread avoidance.

It is also suggested that if the Government is concerned about the deduction of unreasonable entertainment and convention expenses, appropriate provisions to disallow unreasonable expenses are already in the Income Tax Act and only need to be enforced.

Mr. Chairman, that is my summary, and my associates and I would be pleased to answer your questions.

The Chairman: Let us start the ball rolling. You say that your brief is addressed particularly to what you call investment certificates. Would you explain how that works and how the person who subscribes gains in the way of saving and how the proposals in the White Paper would affect him as against his position now?

Mr. Atchison: Our certificates take two forms. First of all, it is what we call an instalment contract, which provides that he pays so much monthly or yearly for periods such as 15 or 20 years. He receives income on the moneys and at the end of a certain time it matures for so much money, which is in excess of the amount he pays in. The difference is the interest gained, and that is subject to tax.

The same thing applies to a contract where he pays a lump sum initially. It accumulates over the period and there is a profit in the terms of interest. Under the present laws, the section normally referred to and called section 35 of the act applies. Under that arrangement this accrual is not profit money until it matures or he surrenders his contract. This is not added to his taxable income. However, his rate of gross tax over the previous three years is determined and averaged, and that particular rate applies to the gain of a certificate.

As we understand the White Paper, section 35 in effect would be rescinded and another averaging arrangement is suggested. We have made calculations to point out that it is much more onerous, even to the point that we are greatly concerned, first of all, for our ability to sell contracts, because section 35 is very important in their sale or their attraction. Secondly, we are frankly concerned that the rescission of section 35 may well result in substantial surrenders taking place and could

even get to the point where it would embarrass us from the standpoint of liquidity.

The Chairman: You mean by enforcing the sale of your investment holdings?

Mr. Atchison: Yes.

The Chairman: Which I understand are mainly Government bonds?

Mr. Atchison: The assets behind the certificates. No, we have Government bonds of course, but 65 to 70 per cent of these assets are mortgages, mostly house mortgages, and the balance are in securities, bonds and stocks.

Senator Connolly (Ottawa West): Are these open-end documents?

Mr. Atchison: No, they are contracts with regular terminations and cash values. The best analogy is the endowment contract of the life insurance.

Senator Connolly (Ottawa West): The income of the earnings is retained.

The Chairman: You will see that in the schedule attached to the appendix.

Mr. Atchison: He is not subject to tax at that time, but rather at the end of the contract.

The Chairman: You have a schedule here covering the 15-year period on the basis of monthly payments of $15.

Mr. Atchison: Yes.

The Chairman: At the end of 15 years you have paid in $2,700 on the basis of $15 a month, and the projection at the end of 15 years is that you might take out $3,600. Therefore, you have a gain of $900

Mr. Atchison: The $900 to which I was referring would be subject to tax.

The Chairman: In section 35 at the present time it enables the taxpayer to determine his average rate of tax over the last three years and the rate of tax that applies to that $900 would be his average.

Mr. Atchison: Yes.

The Chairman: No, exactly how does the White Paper interfere with that?

Mr. Atchison: Perhaps I can give you an example of the difference. For a married man with two children under 16, who is a resident of Ontario with a gross income of $7,500 a year, under this example that $900 would attract $94 by way of tax at the present time. On the proposed averaging arrangement in the White Paper the tax would be $272 instead of $94.

The Chairman: That is solely because he is not entitled to the averaging provision?

Mr. Atchison: The averaging provision is quite different. A five-year averaging provision is not nearly as attractive.

Senator Everett: Could Mr. Atchison explain how it is different?

Mr. Atchison: Could I ask Mr. Walker to explain the difference?

Mr. Wayne S. Walker, Manager, Tax Services, Investors Syndicate Limited: The three-year averaging provision provides for a calculation of a percentage, which is the tax paid over total income before deducting exemptions. The five-year averaging provides for the taxation of income at tax rates which are beyond his normal tax range.

Senator Everett: Do you mean marginal rates?

Mr. Walker: Yes, at marginal rates. If his normal taxable income is $3,000, anything that is averaged is done so at marginal rates would apply to income above $3,000.

Senator Laird: Could I ask if the witnesses have any idea, from information or an educated guess as to what the average income is of an investor in your company?

Mr. Atchison: The average size of investment is in the order of $5,000, either maturity value or dollars invested.

Senator Laird: I am thinking of ordinary income.

Mr. Atchison: It is a little difficult to answer. My friends might care to reply to this question.

Mr. James N. W. Budd, President, Investors Syndicate Limited: It would have to be yes, because there is such a broad spectrum of young family formations on accumulation type plans, and senior people who may be in a retired position. It would be very difficult to just come up with that, although it could be arrived at. I would say that they are modest income people.

Senator Laird: That is what I am trying to get at. Therefore, in your case at least they would be seriously affected by this proposed change?

Mr. Atchison: The whole incentive disappears.

The Chairman: I think your brief goes so far as to say that the people who are buying these investment certificates are doing so because this is really the only form in which they can save, and because they are not otherwise in a position to save. That statement must be based upon some information you have as to the income bracket which the majority of these people would be in. You say modest income. What do you mean by that?

Mr. Atchison: Under today's conditions I would say that we are talking about an average of between $6,000 and $8,000.

Mr. Budd: This depends upon the type of vehicle. For example, there is the instalment contract type, which is one section of our business. The average amount being put away in that section is in the area of $15 to $20 a month. This is some indicator of the type of modest income saver we deal with. A substantial amount of money from people under the $10,000 income bracket could be anywhere to $5,000.

There are other forms of saving, such as the endowment type of insurance policy or savings element in the insurance policy. But section 35 is very important. In calculating or estimating the profitability of such a plan it is one of the real inducements in having people in this category put money away. As the example shows, $94 on one side and a total of $72 on the other. It would actually kill any incentive to save in this form.

Senator Laird: I have forgotten how many shareholders you said it would affect.

Mr. Atchison: Incidentally we have a study made and the figure now is somewhere under 130,000. We have more accounts than that—multiple accounts.

Senator Phillips (Rigaud): You mentioned 135,000 holders. What proportion would that be of the $7 billion?

Mr. Budd: That would roughly work out at $500 million.

Mr. Atchison: You need to find the mutual fund shareholders—assets over $1 billion—when we have $200 million in pension funds assets—it is nearly $500 million.

Senator Phillips (Rigaud): When you get this money, is the obligation merely to return to the certificate holder the capital sum he pays, or does he now get any capital gains in respect of any investment made overall?

Mr. Atchison: There is no equity feature, but there is no credit, depending on earnings over the guaranteed amount.

Senator Phillips (Rigaud): Is there included a contractual obligation to return the capital amount?

Mr. Atchison: No, they are all interest.

Senator Phillips (Rigaud): So we are dealing purely with yield on investment?

Mr. Atchison: Yes.

Senator Phillips (Rigaud): Did you say the overall savings nationally is $2 million on a comparable basis, or $2 million to the 135,000?

Mr. Atchison: A calculation on the tax savings.

Senator Phillips (Rigaud): Is it confined to the newer certificate?

Mr. Atchison: Yes.

Senator Phillips (Rigaud): Would you have any sophisticated guess as to what the total savings would be?

Mr. Jackson: I would suggest we represent 85 per cent of the investment.

Senator Phillips (Rigaud): You do 85 per cent?

Mr. Andrew F. Jackson (President, Western Savings and Loan Association): Yes.

Senator Phillips (Rigaud): Thank you.

The Chairman: Mr. Atchison, I notice your brief (page 5) says:

> The averaging provisions contained in the proposals for tax reform will not apply to the average certificate holder because his gain on the contract will usually not exceed one-third of taxable income.

What do you mean by that?

Mr. Walker: The averaging provision purported in the White Paper provided only for a

situation in which the man's current income exceeded his prior years incomes by at least one-third.

The Chairman: Yes?

Mr. Walker: Because gains on contracts are relatively small and, for example, the one that we deal with in the brief, $900,000—then the averaging provisions in the White Paper would only require that the man's income is under $2,700.

The Chairman: Is this what you are saying, that the averaging provision that presently exists in section 35, under the White Paper proposal is not available to the small man?

Mr. Walker: Yes, that is right.

The Chairman: In other words, whatever income he may get at the end of the period for which he is paying in instalments, will be subject to whatever his personal or individual tax may be?

Mr. Atchison: It will be added to his earned income.

The Chairman: It may have another effect, on increasing the rate?

Mr. Walker: He will probably be paying on the rate at which he has paid before.

The Chairman: You also say that the proposals in the White Paper can only benefit those who are able to invest relatively large amounts? Just illustrate that, will you, please?

Mr. Walker: If a person—62 per cent of all the contracts—if it were for $15 a month or less—if a person were able to save a figure of $90 a month so that his gain at the end of the contract is $5,400—then this $5,400 could very easily exceed one-third of his average income for the past three years.

The Chairman: Yes.

Mr. Walker: And therefore he would be in a position to get the same benefit from the averaging income.

The Chairman: By averaging?

Mr. Walker: Yes.

Senator Laird: So the credit benefit of the system is to the small investor?

Mr. Walker: Yes.

Senator Connolly (Ottawa West): What is the average rate of the earnings of this money for the investor?

Mr. Atchison: It varies somewhat, but the guaranteed rate, for example, on our single page certificates, is 4 per cent; and on current ones we are paying an additional $2\frac{1}{2}$ per cent; so it is $6\frac{1}{2}$ per cent. It is $6\frac{3}{4}$ per cent now. We changed it recently. On the instalment contracts it is lower. They are more costly to administer and it tends to be $4\frac{1}{2}$ per cent, maybe, or of that order, with additional credits. So that it needs the tax incentive to be in any way competitive.

The Chairman: Have you any suggestions, Mr. Atchison, other than not to disturb section 35, in order to deal with the situation?

Mr. Atchison: Because we have lived with it, and the public seem to recognize it as being an incentive, we would just assume, or at least hope, that we could have it remain, with this type of savings.

The Chairman: You have expressed a fear that, if the proposals in the White Paper become law, a lot of the people who are paying on this instalment basis might terminate their contracts?

Mr. Atchison: Yes.

The Chairman: They have that right at any time.

Mr. Atchison: They have, but this would be a disincentive to continue the contract, because it is retroactive in the sense that a contract taken out five or ten years ago no longer would have the benefit of section 35. It would even be subject to the new setup, which again would discourage the individual from continuing to save.

The Chairman: Yes, but if he had paid seven instalments, seven years on the formula, and he decided to stop it before D-Day, that is, before the valuation date, then he can get the benefit of section 35?

Mr. Atchison: Yes.

The Chairman: And have the averaging benefit?

Mr. Atchison: Yes.

Senator Burchill: I wonder if Mr. Atchison has any knowledge of the present income for this at present in the United States? How do you think it would affect this situation?

Mr. Walker: They do not have any incentive formulas along this line for the investment under the contracts.

Senator Carter: The witness has said that most of his clients were people in the $6,000 to $8,000 range. Do you have many contracts by parents who save to educate their children?

Mr. Atchison: That is a very prominent use of this vehicle.

Senator Carter: What would be the average monthly payment on that? Is that spread over 20 years? What is its term—is it 15 years or 20 years?

Mr. Atchison: I think the average would be about the same as it is for business generally, because we have a very substantial portion of our business in this area for educational purposes. It is one of the strong selling points.

Senator Carter: Could you give the committee some idea of how that would be affected? What would you say the worth of the contract was, when he wants to draw it, to educate his child; and how would that be affected by the proposal?

Mr. Atchison: I could refer back to the example we gave, of a married man with two children under 16 years of age, with a gross income of $7,500 a year. That is probably reasonably representative. That $900 profit in the contract—the present tax that he would pay is $94; and under the White Paper proposals it is $272. That is perhaps the best example. I think that would be a fairly representative situation.

The Chairman: Are there any other questions on this aspect?

Senator Phillips (Rigaud): Mr. Chairman, I wanted to deal with the contractual vested rights referred to in the brief and the problems resulting from the proposed changes and the indication of the amount of money that would have to be returned to certificate holders, thereby fanning the flames of inflation in the process—and that is on the assumption that you were able to pay it. Could we get some observations on that?

Mr. Robert H. Jones, Executive Vice-President, Investors Group: As we see the rescission of section 35, we would be under pressure from two sources: one would be the obvious drop in the attraction of our new sales effort to bring new money in; the second would be the inducement to people to cash in their certificates. It could well be that we would argue that everybody should cash in his certificate, whether he now has a loss or a profit, because he may be able to charge the loss against his tax bill; but we are of the opinion that the more likely result would be that those people with a profit would cash in prior to "D-Day", in order to retain the lower rate of taxation. Our reserves in this business are totalling about $187 million, of which $87 million or roughly 40 per cent is above the break-even point. In other words, there is a profit on those certificates to the individual. So we would say that we have a liability exposure here of $87 million. Now, that money is invested in mortgages and in bonds. Our mortgage portfolio is around $280 million, and while it is difficult to relate to market mortgage values, we would estimate that we would have a 15 per cent deficit from book to market in our mortgage portfolio, or roughly $45 million realizable loss, if we could sell the mortgages. In fact, we don't think we could sell them.

We have $83 million in securities which are primarily bonds and preferred stocks, on which at December 31, 1969, we had a market deficit of $17 million. So, if everybody with a profit decided to cash in, and if we could sell the mortgages and the bonds, we would still be looking at a loss of probably $70 million. I think it would be safe to say that so far as this company, Investors Syndicate Limited, is concerned, it would certainly be out of business.

Senator Phillips (Rigaud): Two questions then come to mind: one, are you experiencing a slow-down in contracts obtained resulting from the publication of the White Paper?

Mr. Jones: It is a little difficult at this stage to say whether it is the result of the White Paper itself or not, but we are having a very definite slow-down in our certificate business. I believe it is largely as a consequence of the inflationary trends in the economy and the preference of the individual for equities. I don't think, in all honesty, that we could say the White Paper itself has slowed us down. We don't know.

Senator Phillips (Rigaud): Second, would it help you considerably, if the White Paper concept in this respect were revised to the extent that the new system would only apply to contracts entered into subsequent to the implementation of the new legislation, but that old contracts would be deemed to have a

vested interest to be interpreted under the current section 35 of the Income Tax Act?

Mr. Jones: In reply to that, senator, quite obviously it would be better than what is now proposed. Mr. Budd has much greater sales experience than I, but perhaps he would agree with the comment that, even while that would be better, the very fact that the section 35 would not apply to our future business would mean one of our great incentives for people to buy these contracts would have been removed and on a long-term basis the effect would turn out to be the same.

Senator Phillips (Rigaud): The reason I ask that is that the citizenry at large is simply obligated to pay taxes related to current Government policies from time to time. There is nothing we can do about that, but there is something to be said, as I see it, for the argument that, if the Government introduces incentive legislation which deviates from the normal taxation system, such incentive legislation involves the vesting of rights in the citizenry, based upon the particular incentive that is being given under the act, and it would appear to me that one of the strongest arguments you would have would be (a) the possible existence of a legal vested right, notwithstanding the broad powers of Parliament to tax, and (b) certainly a very strong moral case that incentive legislation surely, if taken away, should not apply to existing contracts.

Mr. Jones: Senator, I would not comment on the legal rights, not being a lawyer, but on the moral rights the retroactivity feature is reprehensible in our judgment.

Senator Phillips (Rigaud): I am glad you use strong terms; I like company.

The Chairman: Senator Phillips (Rigaud), as you know, the practice in the Senate over the years in relation to retroactive tax legislation has been well known to be that, if it is beneficial to the taxpayer, we favour it; if it is not beneficial, we don't favour it. I think that is a fair statement of the general policy. We may sometimes deviate from that. I think you are simply voicing that general position.

Senator Phillips (Rigaud): Thank you, Mr. Chairman.

The Chairman: Are there any other questions on the aspect of the investment certificate feature? Have you anything further to add, Mr. Atchison?

Mr. Atchison: Only to say, Mr. Chairman, that what we say in our brief with respect to section 35 we regard as the single most important part of our brief.

The Chairman: It is the one that affects you the most.

Mr. Atchison: Yes. It is the one with the most serious consequences, if the change does take place.

The Chairman: You enumerated other headings you wished to discuss. Which one do you want to take next?

Mr. Atchison: We can go according to the order of presentation. The second section deals with the inequitable effect of certain proposals, and under that we deal with taxation of investment contract holders, taxation of recovery of capital losses incurred prior to valuation day and taxation of undistributed income accumulated prior to implementation of tax reforms. Do you wish us to deal with that?

The Chairman: Yes.

Mr. Atchison: Here we are thinking in terms, I suppose to some degree, of our mutual fund area; but where a valuation day sets a price and the market value on valuation day is below the original cost of the shares, then we feel that at least there should not be a tax until that original cost has been reached, regardless of the fact of the valuation day market. Perhaps one of my associates can explain that better than I have, but that very briefly is the problem.

The Chairman: Is that problem inherent in your operations?

Mr. Atchison: Yes, because some of our contracts by nature of the earlier charges on them make it very difficult within perhaps a matter of a year or so for anyone to have the market value reach its original cost. And this might very well make us obligated to stop selling, for example, for two or three months prior to valuation day because nobody could hope to have recovered his cost. We think this is a serious area.

Senator Phillips (Rigaud): Mr. Chairman, that strikes at the heart of this whole concept of the capital gain: that it should not be related purely to the valuation date but surely should take into consideration the original cost.

The Chairman: It is involved in what is a capital gain. A capital gain surely cannot be a value that is established at a certain date, but must be in relation to what it cost. At least, it would appear that way to me.

Mr. Atchison: That is our concept.

Senator Beaubien: In my view we should look at this very carefully because the Minister could say if the cost were very low on valuation date that it was not a true valuation.

The Chairman: We are talking about a capital gains tax, and you have to have a starting point for the purpose of the valuation. So taking the starting point, any mark-up that is made after that valuation date is in the category of a gain.

Senator Phillips (Rigaud): It is a perfectly legitimate approach to take the cost on valuation date, or true value, whichever is higher.

Mr. Walker: Unless you are calculating a loss.

The Chairman: In other words the valuation date and the procedure by which you establish it is more than simply what the value is on that date. You may value at inventory, or you may show it as being higher. Any other questions on this aspect?

Senator Phillips (Rigaud): The only other observation deals with the reverse in P and L where you have the principle of determining value at inventory cost or market whichever is lower. You have the variation there from a different point of view.

Senator Everett: I would like to address a question to Mr. Atchison in view of the fact that he has views on the valuation date and on the re-valuation date which appear in his brief. I wonder if he has any views on capital gains tax as such.

Mr. Atchison: Well, I think that there is a very good case for a capital gains tax *per se*, and the American model is more along the lines of the type of tax that I would have in mind personally. This is not a subject that we have really discussed very much from a company standpoint. We have accepted the fact that we are going to have a capital gains tax, but certainly this type of tax should favour the long-term investor, and of course this five year re-valuation is something of which I cannot make any sense at all.

Senator Everett: As I understand the capital gains tax under the Whie Paper, capital gains are classified as income and thereby attract an income tax rate and in your home province the rate could be as high as 55.6 per cent. In the case of widely held corporations that is reduced by a tax dividend credit. Therefore I am wondering if what you are saying is that the American model which appears to be a flat 25 per cent tax on capital gains which are separated from income and not classed as income and are definable by rules—do you mean that would be a better system?

Mr. Atchison: Yes, in my view.

Senator Connolly (Ottawa West): Have you attempted to make any kind of assessment of what the possible loss in revenue would be if a capital gains tax act were enacted rather than the proposal contained in the White Paper.

Mr. Atchison: Speaking for myself, I have not.

Senator Connolly (Ottawa West): Have any of your people?

Mr. Jones: I am afraid I have not attempted to.

Senator Connolly (Ottawa West): I wonder if Mr. Gilmour has.

Mr. Gilmour: Not yet, but it will come.

Senator Everett: You seem to be in favour of the American capital gains tax system. Have you any idea what rate that would amount to?

Mr. Atchison: It would seem that there is a very clear difference between a gain realized as a long-term investment over an extended period and short-term trading, say, within six months or a year. I think there is logic behind the idea that the short-term trading could either be considered as part of income or could be at a higher rate than that levied on long-term capital gains.

Mr. Jones: I would like to suggest that we give a lot of thought to this. Perhaps the principal reason we would offer for the American method is because it is understandable and it is simple. If you want to discuss a rate we will automatically say 25 per cent on the basis that the proposed income classification of capital gains works out at 25 per cent.

Senator Everett: Would you be satisfied that all items classified as capital gains should be taxed at the 25 per cent rate? In other words, there would be no difference in classification of a capital gain as presently stated in the White Paper.

Mr. Jones: We would say that all items of a capital gains nature should be taxed at a capital gains rate of 25 per cent.

Senator Connolly (Ottawa West): Even the quick turnover.

Mr. Jones: We would not classify that as capital gains.

The Chairman: Of course we know that under the present act a person making what I called the other day "a fast buck" which is a short-term transaction where you buy and sell within a period of six months under the United States legislation, it might very well be that such a person would have his gain classified as income under the present law, and if you accept that, then his position in the White Paper is better.

Senator Laird: And that is so even if it is an isolated case.

The Chairman: Because there he would be taxed at his present rate.

Senator Beaubien: And under the present law it is not restricted to a short-term period either.

The Chairman: Another consideration is that it depends upon what the White Paper defines as a capital gain. Will it exclude anything that the Courts have now decided is income? They could write such a definition of capital gain that would exclude the making of a fast buck. Then that would be subject to income tax.

Senator Cook: That would not simplify the law. It would be the same as it is now.

Senator Connolly (Ottawa West): Mr. Chairman, am I wrong in this—to use your language, the making of a fast buck and the making of a capital gain realized over a long-term investment are going to be taxed in the same way under this Paper. They are going to be added to the top of the income.

The Chairman: What is the definition in the Paper?

Senator Connolly (Ottawa West): I don't know the definition, but I understand the scheme of the Paper is that after the normal earned income is accounted for, on top of that in effect you get your capital gains added as part of your income, whether it is a fast buck or long-term appreciation of an investment, and when you take that—and I disregard the 5-year revaluation—it is part of your income.

The Chairman: That may be, but certainly you cannot conclude that from reading the White Paper. I think the situation still remains that you have to decide what is a capital gain. However, that is just my view.

Mr. Gilmour: Senator Connolly, to answer the question you have raised, certainly the proposal today is that all gains be thrown into income; and when you analyze that you realize that today in the average corporation there are literally no capital gains left untaxed. When you look at a corporation such as is appearing before us, the Investors Group, any profit they may make from short-term investments—buying treasury bills and so on—falls into corporate income today, and practically the only profit which might escape taxation would be on the sale of a massive portion of the company's business itself. Of course, under the proposals of the White Paper such a profit will fall into income.

Similarly, when we look at the individual today in Canada, Canada has not attempted to tax stock market losses or gains, other than if you are an investment dealer, and today the items that will be brought into tax are the profits on the sale of your principal home or the family heirlooms—very little else; and it is conceivable that the fundamental flaw in our proposal is that we all talk of capital gains, but there are such things as capital losses and, as the United States found, where you have the right to charge a capital loss against earned income a bad drop in the Dow Jones can, if unchecked, wipe out Canada's revenue in one year. Because of that, the Americans, back in the bad days of 1930 and 1931, passed legislation such that there was a very definite limit placed upon the deductions of losses that could apply against earned income. Frankly, under our proposals in the White Paper we are walking right into that old trap.

Senator Everett: The Americans achieved that by virtue of the fact they had a separate capital gains tax.

Mr. Gilmour: Yes.

Senator Everett: And they passed the 1930 legislation and confined capital losses to capital gains tax.

Mr. Gilmour: Yes, and they had to limit the old proposal that if you had a capital loss there was a provision that that net long-term loss could be amortized against income. They put a check on that, and today, I believe from the research that I am doing for this study, you have about $1,000 a year for your long-term loss that can go against earned income. However, every country that has introduced capital gains or capital loss legislation has had to come to the logical conclusion that the country must depend upon the earnings of its people to finance, and if we have some arrangement that enables the tax on the earnings to be wiped out through what are called tax loss sales in the United States, we will very quickly be financing a dreadful deficit.

Senator Everett: But if you have a separate single-rated capital gains tax you do not have that problem.

The Chairman: It depends on what you might write off the loan against.

Senator Everett: I say that if you have a separate tax so the loss is deductible from the capital gain portion of the tax, from the capital gains tax, then you avoid that problem.

The Chairman: You avoid shrinking your taxed income from earnings. So, when you were talking earlier about comparing the method in the White Paper on capital gains and losses with a specific rate in the United States, I do not think we should jump too quickly and say we favour the specific rate as against what the White Paper does, because you might be going into a situation where the general tax revenues of the country might be affected in certain circumstances.

Senator Everett: I was asking what, in the United States, their concept of the rate was.

Senator Connolly (Ottawa West): What Mr. Gilmour has said is a very important philosophical factor in our discussion, because it is conceivable that by adding capital gains to the top of earned income or investment income and taxing it at the top rate and also providing for capital losses which you deduct, you might very seriously affect the whole basis of taxation in the country and the needs of the government for revenue.

The Chairman: The White Paper may be attempting some check of that kind by making it only 50 per cent of the capital gains or 50 per cent of the capital losses, but even that, in certain circumstances, might not be enough.

Senator Everett: But you are referring to only one single capital gain type of transaction, that is in shares of a widely-held corporation. Do you exclude the man who decides to invest in paintings, for example?

The Chairman: For instance, every share of the widely-held corporation that may be sold, if there is a gain, half the gain is part of your income.

Senator Everett: But only in that specific circumstance. In all other circumstances the entire gain goes to income.

Senator Cook: If you sell your picture there might also be an entire loss.

Senator Everett: The entire gain or the entire loss goes into income.

The Chairman: There might be an area in between we have to explore, because it would not appear that the proposal in the White Paper is 100 per cent satisfactory, and it may well be that the United States system may be satisfactory, but there are problems there which they have attempted to check simply by letting you relate your losses to your gains and not affect your earned income.

Senator Everett: I happen to contend that all gains should be taxed at one rate, if there is going to be a tax, and there should not be a preferential gain of one form or another.

The Chairman: You are not calling the gain of making a fast buck income?

Senator Everett: That is not a gain. In the conversation we have had we have said that is income, so that is out, but what we would logically define as a capital gain, I am saying, regardless of where you make it—if you want to invest in painting or widely held corporations—the gains should be taxed at the same rate, flat, overall, and that rate should not be part of the income rate.

Senator Benidickson: It is basically the American system.

The Chairman: With the limitations of the American system.

Senator Everett: I suppose the limitations are bad for us.

Senator Carter: Following Senator Everett's argument, my problem is, how do you distinguish what is capital gain and what is actually the effect of inflation? He spoke about it not mattering how you make your gain. Suppose you built a house for $20,000 and over a period of 20 years the cost of labour, materials and everything else has gone up, and you sell that house, say, for $30,000, I would not consider that a capital gain because if I have to buy another house I still have to pay $30,000. There is no benefit to me, but I will be taxed on that amount.

The Chairman: Under the proposal in the White Paper, yes.

Senator Carter: To my mind that increase is caused by inflation. It is not a true capital gain. I am not an economist so I may be wrong, but I would like to have that cleared up.

Mr. Budd: Mr. Chairman, this introduces another thought for your consideration. We are talking about small earners who are accumulating a future income over a long period of time. They are seeking anti-inflation vehicles so that their savings will not be eroded by inflation. Much of our discussion on this matter of a tax on capital gains has been on how it relates to mutual funds. A small earner who has the desire to achieve a certain degree of financial independence later on in life disciplines himself to put away some of his earnings. The honourable senator has introduced a very good point. Let us assume that through a mutual fund the accumulations of that small earner will appreciate at the rate of 8 per cent per annum. At the end of the period there is a sizeable appreciation of the actual amount he has put in, but much of that is not true capital gain. It has been eroded by inflation. There is in it an inflation factor.

I suppose if we were to poll—and this we have not done—300,000 of our clients who are small earners, and ask them for their views on a capital gains tax, they would say it is fine for people who have capital, but if they thought that it applied to their savings over a lifetime then they would think it is just terrible.

It may be that there is a case to be made for a tax on certain types of capital gain, but not when you consider the person about whom we are talking, namely, the small investor who is using this as a medium for putting away a few dollars.

Senator Everett: That is a point that is well made.

The Chairman: Are there any other questions on this aspect? If not, what is your next heading, Mr. Atchison?

Mr. Atchison: It is "Taxation of Undistributed Income accumulated Prior to Implementation of Tax Reforms".

Senator Phillips (Rigaud): Do you cover what happens upon the distribution of undistributed income?

Mr. Atchison: Yes, we cover that as well.

Mr. Jones: Yes, that is paragraph 4.78. It is dealt with on page 10.

May I say in relation to this heading, Mr. Chairman, that we have written what follows with some trepidation because we must say that we do not understand this proposal. We are more concerned with what we believe is the implication of the section rather than the actuality.

Senator Connolly (Ottawa West): Do not worry about not understanding it.

Mr. Jones: We were not quite certain whether we should put it in on the basis of saying: "Here is something that could hurt us", and perhaps get a reaction from the honourable senators who perhaps know what is actually intended.

Our main contention, of course, is that if this section is designed to encourage businesses to get rid of excess surplus, then that is one argument upon which we would have no view because we are not in that position. What we are concerned about is the implication here, as we read it, that all surplus, even that necessary to run your business, should be removed, and if it is not removed at some stage you are going to be hit with a tax. To be perfectly honest, we do not understand the section.

The Chairman: I should interject here to say that Mr. Gilmour tells me that next week he will present a study on the 15 per cent tax, which is the matter under discussion now. From that we will obtain some understanding, and in due course you will be able to read Hansard's report of the committee's proceedings next week.

Mr. Jones: That will be very helpful.

Mr. Jackson: There is another situation that affects our company particularly. We

operate across the country under various provincial acts. In Saskatchewan, for instance, we are required to maintain assets in excess of our surplus, with a 5 per cent margin. This margin can be represented only by our capital and surplus account. So, we are concerned that if there is a forced distribution of surplus we will not be able to meet the requirements. We will be caught on two sides.

Senator Everett: Do you find anything in the White Paper that indicates a forced distribution?

Mr. Jackson: This is one of the questions that is unanswered. As Mr. Jones stated, we are not sure how this 15 per cent tax will work.

Senator Everett: I am wondering in what section of the White Paper you read this. I can find a section which says it can be distributed, but I am wondering if there is a section that says it has to be distributed.

Mr. Atchison: It is paragraph 4.78.

Mr. Gilmour: Could I answer Senator Everett, Mr. Chairman?

The Chairman: Yes.

Mr. Gilmour: Paragraph 4.78 and following seem clearly to relate to the closely-held corporation, and not to the widely-held corporation. The paragraph, as it applies to the closely-held company, can produce some terrible inequities. I hope to give you some actual examples, but there appears to be nothing in the White Paper that relates to the accumulated surplus of a widely-held corporation. Logically, if we adopted this grossing-up system, there will be a provision, but at the moment the only reference is to the closely-held corporation.

The Chairman: In paragraph 4.78 there is nothing to indicate compulsion.

Senator Everett: In view of what Mr. Gilmour has said, would you be inclined to withdraw your suggestions?

Mr. Atchison: I think, Senator Everett, we have another problem that relates to this, and that is how you classify wholly-owned subsidiaires of a public company. Investors Syndicate here, which is our main operating company, is a wholly-owned subsidiary of The Investors Group. Is Investors Syndicate Limited a closely-held corporation, or does it come under the general classification that applies to the parent? We are not clear on that.

Senator Everett: You seem to suggest here that after valuation day, or after the act comes into force, that intercompany dividends of surplus, from subsidiary to parent, of Canadian corporations, achieved prior to the coming into force of the act, would not pass tax-free.

Mr. Atchison: That is right.

Senator Everett: I wonder if we could ask Mr. Gilmour for his view on that, Mr. Chairman?

The Chairman: Are you ready to comment on that, Mr. Gilmour?

Mr. Gilmour: Mr. Chairman, I was busy writing you a note, and I did not hear the question clearly. May I ask Senator Everett to repeat it?

Senator Everett: The Investors Group, in their brief, seem to indicate, if this proposal in the White Paper is put into effect in the form of a budget, that after that date intercompany dividends of surpluses of Canadian corporations achieved prior to the budget would not pass tax-free as they do today.

The Chairman: You did add "from subsidiary to the parent". Do you still want that limitation in there?

Senator Everett: That is the specific case they make, but the present law is that they are tax-free either way.

Mr. Gilmour: Assuming your subsidiary is a closely-held corporation, as ordinarily it is bound to be even though the parent may be a widely-held corporation, the sections of the White Paper that relate to dividends and accumulated surplus of a closely-held corporation indicate that before earnings can pass free of tax you must first pay a 15 per cent tax upon the accumulated surplus of the closely-held corporation on the undistributed income, because it spells that out. It is silent as to any accumulations of surplus that are not undistributed income. Most companies have such surplus on their records. Therefore it appears that the undistributed income accumulated before the date the law is accepted must be subjected to a 15 per cent tax. Then the remaining 85 per cent of that surplus must come forward as a reduction of the value of shares held in this closely-held corporation. In other words, we are proposing

a system that because a company pays a dividend will automatically reduce the value of the company. That is a concept that has not ever been recognized in Canadian financial circles. A stock will go ex-dividend for a short period, yes, but we are paying with respect to the accumulated undistributed income, that must be taxed first at 15 per cent then, when it transfers across to the parent, it must be applied to reduce the cost of the investment as of V-day.

Senator Everett: Does that mean you get an offsetting tax credit due to a capital loss?

Mr. Gilmour: No, you now have a lower value, then if you ever sell those shares you are going to get hit with a capital gains tax on this increased amount, namely the 85 per cent of your surplus, so that we are aggravating the whole thing, though if there is a capital surplus accumulated prior to V-day that presumably will be taxed at the full 50 per cent. Then, being a closely-held corporation, there is a requirement that if you are to receive a tax credit you must act within two and one-half years. We have some very strange results from what at first glance appears to be a reasonable proposal: pay 15 per cent tax on your accumulated surplus and bail yourself out, which is the law today. We are departing from that and now subject the accumulations before V-day to 50 per cent.

Senator Everett: You say that is the law today?

The Chairman: Yes.

Mr. Gilmour: Yes.

Senator Everett: On what basis?

Mr. Gilmour: Under section 105 and its various subsections it is possible today to clear out existing accumulations of undistributed income by payment of varying rates of taxes, some at 15 per cent, some at $16\frac{2}{3}$ per cent. I could make the categoric statement that any closely-held corporation today could bail out its surplus for a tax not in excess of $16\frac{2}{3}$ and probably nearer 15 per cent. This accumulated surplus is going to be taxed, retaxed and retaxed under our White Paper proposals. I hope to put this in arithmetical form, but it really means today that if any businessman has a closely-held corporation, be it manufacturing or a financial holding company, and had accumulations of surplus, he should certainly liquidate that company before the White Paper proposals come in. He will save a great amount of tax by doing so.

Senator Benidickson: What do you mean by liquidate, Mr. Gilmour?

Mr. Gilmour: Remove its assets, surrender its charter and either re-incorporate or use the old charter again. You should not sit idly by with accumulations of surplus today, because it will cost you much more in the future.

The Chairman: Would you follow along with Senator Everett's inquiry? You have an accumulation prior to V-day as I follow you and that must be cleared out at 15 per cent when the White Paper proposals come in. This is a closely-held company that goes to a widely-held company so that is income in the hands of that widely-held company. When the widely-held company starts paying a dividend and applying its tax credits, the only tax credit available in respect of that portion of the earnings being distributed would be the 15 per cent.

Mr. Gilmour: Subject to one thing, Senator Hayden: under the White Paper proposals the surplus of the closely-held corporation must be subject to a 15 per cent tax. It has already paid under the present system 50 to 52 or 53 per cent.

The Chairman: That is right.

Mr. Gilmour: Then there is this additional 15 per cent on the net.

The Chairman: For the privilege of paying it out.

Mr. Gilmour: Yes, for the privilege of transferring it as a capital receipt to the parent and applying this 85 per cent that is left against the cost of the investment in the subsidiary. It does not fall into income under the White Paper proposals; it reduces your cost so that ultimately if the widely-held parent ever disposes of that subsidiary there will be the usual 50 per cent income tax on this capital gain, computed on a decreased cost. Now, this may not be too serious in the case of a widely-held corporation, because normally they do not dispose of subsidiaries, but when you get into the position of the individual shareholder the results are most costly.

Senator Phillips (Rigaud): In a sense the dividend is a reduction of cost, rather than a yield on capital.

Mr. Gilmour: And it can be today, as you know, senator.

The Chairman: Are there any other questions on this aspect?

Senator Connolly (Ottawa West): I did not quite follow you, Mr. Chairman, which is most unusual. A subsidiary who takes advantage of section 105 (a), pays a 15 per cent tax and distributes 85 per cent of the accumulated surplus to its parent, or perhaps the parent and other shareholders...I am sorry; I think you are clear after all.

The Chairman: Thank you, senator. It just took a little concentration. Are there any other questions on this aspect? Is there anything more you want to add, Mr. Atchison?

Mr. Atchison: No. Page 13 deals with the taxation of foreign income of a Canadian subsidiary. We use the example in our own case of Great-West Life, which is a control situation; they do a lot of business in the United States, and probably half their income comes from the United States. It would appear that the only way we can get around the proposals in the White Paper would perhaps be to form an independent subsidiary in the United States which we would own, and this is not a practical kind of thing to do in this instance. Again perhaps my associates could deal with this better than I can.

The Chairman: Great-West Life is a Canadian corporation?

Mr. Atchison: Yes, doing business directly in the United States, not through a subsidiary.

The Chairman: So it is a branch operation in the United States?

Mr. Atchison: Yes.

The Chairman: What is your position now taxwise? Do you pay tax on your operation in the United States?

Mr. Atchison: Yes.

The Chairman: And bring income to Canada?

Mr. Atchison: Yes.

The Chairman: You get credit for the tax paid. Is that right?

Mr. Atchison: Yes, that is right. In dividends paid by Great-West Life no differentiation is made as to the source.

The Chairman: What are you fearful of under the White Paper?

Mr. Jones: Under the White Paper, as I understand it, the earnings in the United States would be remitted to Great-West Life to get full tax credit back and forth. However, when Great-West Life pass a dividend to us there will be a tax levy on the portion of that dividend that is deemed to arise from its American earnings, whereas today there is no such tax levy.

Mr. Walker: This would not be the case if Great-West Life was a United States subsidiary. The exemption for dividends from the foreign subsidiary still applies. It is only because it happens to be a Canadian corporation that the tax situation arises.

The Chairman: It is only because it is a branch operation of a Canadian company in another country.

Mr. Walker: Yes.

Mr. Jones: It would also arise if the operations of Great-West Life in the United States were run through a subsidiary owned by Great-West Life. Then the tax would still be levied as if it passes from that subsidiary to Great-West Life or to us. It would only be avoided if we owned the subsidiary directly in the United States.

The Chairman: You mean if shares of Great-West Life were held by a foreign subsidiary?

Mr. Jones: No, sir. I mean if Great-West Life were to spin off its American operation so that it could no longer be a subsidiary, but the present shareholders of Great-West Life held directly the American subsidiary, there would be no tax levy.

Senator Everett: Why is tax levied after you create an American subsidiary held by Great-West Life?

Mr. Jones: The tax, I understand, is levied as it passes from the United States, whether or not it be a branch. In other words, it is because there is a second layer.

Mr. Jackson: The foreign content of their dividend to us.

Senator Everett: I appreciate that is the effect. I was wondering if you could explain in slightly more technical terms why that is the effect.

Mr. Walker: Great-West Life would be exempt on dividends received from the foreign subsidiary, and therefore the divi-

dends on the United States subsidiary would pass into Great-West Life tax free.

Senator Connolly (Ottawa West): In Canada.

Mr. Walker: Yes, but there would be no creditable tax related to that income, so when Great-West Life paid out a dividend in excess of its earnings there would be no creditable tax available to any of the shareholders, and therefore we would pay tax on the dividends.

Senator Everett: If there is no tax imposed on the ultimate shareholders of Investors there is no creditable tax.

Senator Beaubien: There would be no change there.

Senator Everett: Assume for the moment you do spin off.

Mr. Walker: To the ultimate shareholder there would be no difference, but it certainly creates difficulties within the corporate chain.

Senator Everett: Where you spin off an American subsidiary of Great-West Life which is owned by Investors Group, the income of Investors would be tax free, but if your argument on creditable tax is correct, then the owners of Investors Group and poor old Mr. Desmarais would not get any credit.

Mr. Jones: I believe that is correct.

The Chairman: Are there any other questions on this point? You are pointing out the effects of the proposals in the White Paper. What is your suggestion, that we just leave the law as it is?

Mr. Walker: Our suggestion would be that dividends passing between corporations should continue to be exempt from tax. The appropriate amount of creditable tax would pass along with the dividends. The tax would then be levied on the ultimate shareholders. This makes a difference where the ultimate shareholder is, for example, a pension plan. The number of corporations between the pension plan and the basic income significantly affects the amount of tax paid. To tax income passing between corporations would make it very difficult to operate with a group of companies in many situations.

The Chairman: What is the next point?

Mr. Aitchison: We go to page 16, expenses incurred in the course of earning dividends or capital gains from a widely-held Canadian corporation. This is a fairly technical accounting problem. Perhaps Mr. Jackson would deal with this.

Mr. Jackson: We are concerned at the present time that expenses incurred to earn tax exempt income are not allowable expenses. We urge that consideration be given to the allowing now of expenses for the earning of Canadian dividends.

The Chairman: This is a proposal to add to the White Paper?

Mr. Jackson: Yes. I think there is an advantage in America as opposed to Canada in any financial arrangement. In the United States expenses laid out to acquire shares, for example, are permitted as a tax deduction, whereas in Canada, this is not the case. It leads to arrangements mainly for tax purposes, to finance such acquisitions or purchases of a capital nature. We contend this is not a good arrangement, that it discourages and complicates acquisitions or such purchases. We urge that when appropriate legislation is introduced there should be reasonable guidelines established for allowing expenses.

Senator Connolly (Ottawa West): Are you talking about such things as accounting and legal expenses, economic analyses and that sort of thing?

Mr. Jackson: Anything which would normally be capitalized, which would be considered a capital expense. We are primarily concerned with the interest cost laid out in connection with the acquisition of capital assets of some sort, particularly shares in this case.

Mr. Jones: I think also in this section we have inadvertently perhaps touched upon an area in which I am sure this committee would be most interested. It has a much broader implication than in this particular section. That is the difficulty of tax administration in this country, the apparent inability to know just what your tax liability is. In this particular area we have found this to be true. We noted, when talking about our certificate business, that the inroads of inflation had adversely affected that business and was gradually destroying the fixed income concept. In an attempt to combat this we have given a great deal of research and effort to try to combine fixed income with an equity portion so that we can continue to bring men into the fixed income side. We thought that

we had designed a lovely instrument for such a purpose. It became uneconomic, on the basis that the proportion of the certificate which we would have in the hands of the client was dedicated to equity. Because of this the expenses we incurred to provide that equity would be disallowed. That made our whole certificate uneconomic. I think it is in this type of area that we find a great deal of concern. We also are a little disturbed at what is especially a poor bargaining process between the taxpayer and the tax department to set out what the disallowable and allowable expenses are. There is a lack of clear guidelines in this whole area.

The Chairman: This is addressed to the present situation?

Mr. Jones: Yes, sir.

The Chairman: What do you propose?

Mr. Jones: I believe we admitted defeat in our last paragraph, by saying that we do not have a good proposal other than that guidelines be formulated at the time new legislation is introduced and that we would not resort to a bargaining process.

Senator Phillips (Rigaud): If you were to introduce a capital gains tax based on the United States system, then the problem as to what the cost of a capital asset is could be determined by an equitable system of including cost of acquisition, advice and appraisals. I do not see how you can include in cost of operations charges related to the earning of dividends. I find that a bit stretched.

Mr. Jones: I am inclined in one way to agree with you, senator, that the concept of income being tax exempt and claiming expenses against that does seem a little far out. Other people might argue that the corporation has already paid a tax. It depends how far you wish to go.

Senator Phillips (Rigaud): The cost against the capital asset is another matter.

Mr. Jones: Yes, sir.

Mr. Jackson: It puts Canadian corporations at a disadvantage to American corporations in the acquisition of property.

The Chairman: Senator Phillips, it is a question, of course, of whether there is any area for pure philosophy and logic in dealing with any tax problem, and it very often is a matter of expediency or making the rules workable.

Senator Phillips (Rigaud): My experience is that it is a matter of art and footwork.

The Chairman: That is right. Are there any other questions regarding this point? Mr. Atchison, what is next?

Mr. Atchison: We deal next with page 18 in regard to the five-year revaluation of widely-held Canadian shares.

The Chairman: I take it the answer is that you are against it?

Mr. Atchison: Yes.

The Chairman: Would you care to add anything more to your positive no?

Mr. Walker: I have one remark to make. We discussed earlier the possible revenue effects of a fall in the Dow Jones. If you foreced everybody over a five-year period, when the market is high, to revaluate their shares at these higher prices, then when the market does fall back you have an exaggerated revenue problem because of the five-year revaluation. You have brought in extra income over the previous five years. If the market falls back you must return it all.

The Chairman: That would appear to be a basic problem to look at. The five-year revaluation is a deemed realization. You have not realized that if the revaluation increases the value you are deemed to have made is a gain and you pay tax.

Mr. Jones: Yes.

The Chairman: I suppose that is about the strongest argument you could make in connection with the five-year revaluation plan.

Mr. Atchison: Mr. Chairman, as an example, in the case of our mutual funds, it is quite conceivable that many, many people would have to sell assets in order to pay the tax.

The Chairman: Or, as Mr. Bryce said the other day, if they could not get the money any other way they could borrow it, which is an unusual concept for tax purposes.

Senator Everett: It seems to me that a very valid point would be that an individual, controlling a widely held corporation may, by virtue of the exercise of the revaluation rules, be attracted, because he has to sell off over the five-year period, his control, while it is control and thereby worth a great deal more.

Mr. Atchison: There is a premium normally on control.

Senator Everett: It would seem that you are in favour of the maintenance of control situations where they exist.

Mr. Jones: I would rather rephrase that, senator. We are in favour of not forcing individuals to take action for their own best interests.

The Chairman: I think the better phrase would be that there is compulsion to take gains.

Mr. Atchison: Freedom of action.

Senator Everett: I was wondering how you relate that to the ultimate paragraph on page 19 in which you seem to say that a similar situation in a closely held corporation should not be perpetuated.

Mr. Jones: Will you rephrase that, please?

Senator Everett: It appears to me that in looking at that paragraph, you are saying that a similar situation in the case of a closely held corporation should not be perpetuated.

Mr. Atchison: We have in mind that they should not be deterred from going public if they want to. Again, it is the freedom of action that is penalized.

Senator Everett: So you are permissive in both cases?

Mr. Atchison: Yes.

Mr. Walker: There is one thing, if a man who is controlled decides that he better sell control before he has to give it up, then to whom does the control go? Does it remain in Canada or go outside?

Senator Everett: That is an excellent point.

The Chairman: Of course, there is the problem in this connection which I mentioned the other day. The control situation would mean that the person is an insider under the securities laws in the various provinces. If he were going to make any disposition of these shares he would have to file statements, and the general public would know that he was in the market and bidding. The possibility of a premium on control might not exist to the same extent.

Senator Everett: It might be diminished.

The Chairman: Yes.

Mr. Atchison: Mr. Chairman, this would happen if he sold over a period, but the reporting is frequently after the fact, because the selling is done at one time. I think that generally speaking a premium on control is probably reasonable.

The Chairman: Would it still be expected?

Mr. Atchison: Yes, the amount.

The last one which we have is on page 20 and deals with the disallowance of convention expense. This is quite important to us, because conventions, where the sales organizations have become the order of the day, are not all fun and frolic by any means. There is a good deal of teaching and seminar work. This has become the order of the day. They are not all fun and frolic by any means. There is a great deal of teaching, and seminar work is important to us and we feel that with the present legislation could deal with it, if it is properly released and there is no reason to introduce new legislation here.

The Chairman: Are there any questions, or any comment on this?

Senator Everett: There is nothing on that, Mr. Chairman, but I would like to come back to the earlier point on the taxation of undistributed income prior to the tax reform.

As I understand your comments, they are meant only to apply to the problem of widely held corporations that may hold closely held corporations as subsidiaries.

Mr. Atchison: Well, that is our particular position, yes. I think our comments probably are a little broader, in that we are investing in very many companies and therefore we are concerned in a broad way, with corporate structures and corporate problems of this kind.

Senator Everett: But you make the comment that it would have quite an effect on closely held corporations that are not held by widely held corporations?

Mr. Atchison: Yes. You are referring to closely held corporations other than wholly owned subsidiaries?

Senator Everett: Yes. Did you intend that your comment shall affect that situation?

Mr. Walker: What specific comment?

Senator Everett: As I understand it, you were referring to your particular case, which

is that of a widely held corporation controlling certain closely held corporations; and your comment applied to that situation.

Mr. Gilmour has stated that the rules under 4.78 more likely apply to a closely held corporation held by shareholders and not by a widely held corporation. I gathered the tenor of our discussion was that you do not intend that to apply to the situation but rather to your own situation.

Mr. Atchison: I think that if our wholly owned situation were deemed to be that of a widely held corporation, because their permit is so, then we are not strictly concerned; but our theory is that our wholly owned subsidiary would be classified as a closely held corporation.

Mr. Walker: You did not see any limitation in classification 4.78, a limited application of that to closely held corporations? It just said "corporations".

The Chairman: Mr. Gilmour's suggestion was that he thinks it is intended to delimit it to closely held corporations.

Mr. Walker: This is the first indication that we have that it may be limited to closely held corporations.

The Chairman: In that event, you are not concerned.

Mr. Walker: Except that our closely held subsidiaries are closely held—one shareholder.

Mr. Jones: I think that the answer is that we looked at this from our own point of view, yes.

The Chairman: I think Mr. Gilmour would like to add something.

Mr. Gilmour: I know it is not my purpose today to offer any tax commentary; but where you are faced with the existing situation today of a subsidiary with an accumulation of surplus, a subsidiary company, a closely held corporation, the thought has been going through my mind, why not, shortly before D-Day, pay a dividend?

Senator Everett: They have pointed out, Mr. Gilmour, in the brief, that they may be precluded from doing so, by virtue of stock issue requirements and bond issue requirements, to retain a certain portion of their surplus.

That is, in your particular case?

Mr. Atchison: Certainly at the present time, which is one of very large deficits in market values, that surplus certainly is necessary, because we may well have—in fact, we have—liquidated assets below our cost, and that can only be charged somewhere, and presumably will be charged to surplus, so a surplus very definitely is necessary at the present time.

Senator Everett: There would be nothing to prevent, in effect, capitalization by paying out a dividend and taking it into account?

Mr. Jackson: You go through an artificial situation of paying out a dividend.

Senator Everett: That is probably what Mr. Gilmour suggested.

Mr. Gilmour: It was just a thought.

The Chairman: He was just dropping a few seeds here and there. You have nothing to add?

Mr. Atchison: No.

The Chairman: On behalf of the committee, may I thank you for the statement you have made and the earnestness with which you have presented your problem. May I say that, when all this is put into the computer—if I may call this committee a computer—we shall see what comes out.

Mr. Atchison: Thank you very much. We in turn appreciate the kindness with which you have treated us in every way.

The Chairman: Honourable senators, we have another brief this morning. It is from the Canadian Realties Fund for Quebec Limited. You have the brief before you. You also have Mr. Gilmour's comment.

Appearing for Canadian Realties Fund is Mr. H. Heward Stikeman, Q.C., of Montreal, who should be well known to every person here. As a matter of fact, this is my second experience with him on income taxation committees. I think the first one was about 1945.

The other members of the delegation are Mr. E. Schousboe, Manager, Canadian Realties Fund and Mr. John P. Kinghorn of Riddell, Stead & Co., Chartered Accountants.

Mr. H. Heward Stikeman, Q.C., Stikeman, Elliott, Tamaki, Mercier & Robb, Representing Canadian Realties Fund for Quebec Limited: Mr. Chairman and honourable sena-

tors, we have two versions of our representation—one in French and one in English. In addition I have had prepared, and there is now being circulated to you, a statement of assets and liabilities of the fund as of December 31, 1969, the actual statement of affairs. Then I have one prepared by Mr. Kinghorn, on the assumption that the White Paper would be applied to it. So that you will be able to see in figures, using actual experience as an example, what would have been the case had the White Paper been in existence for the 1969 year. I also have some figures which I will allow you to put on later, showing the position of an individual investor under the White Paper.

We come here this morning very full of hope, for the reason that the White Paper itself seems to indicate that not too much is known about the treatment of the use of trusts in Canadian tax law, and the authors of the White Paper in that document state that they would welcome submissions expanding their knowledge on the utilization of trusts in Canada. We feel that this absence of knowledge which is stated in the White Paper may have given rise to the anomaly that catches Canadian Realties Fund, and, therefore, we do not come as a real complainant but come as a hopeful suppliant that the matter might be corrected once it is brought to the attention of the Government.

The Chairman: You mean that the present law might be perpetuated?

Mr. Stikeman: In effect, yes, although we don't go that far. We take the position that, if the White Paper is to come in, we as a real estate investment trust should place our unit holders in no different position from that which would be the position of an individual who had a direct ownership in real estate in Canada. We are not saying the White Paper is wrong: "Don't do it". We merely say that if you do it, let our unit holders be treated just as they would be if they held directly instead of through the medium of a trust, which is the case under the income tax law at this moment. So if there are changes affecting the individual holders of real estate in Canada, then, for better or for worse, the White Paper should let us have the same position, because a trust is not, as the authors of the White Paper seem to imagine, a separate entity. It is merely a conduit pipe for holding in group form the individual interests of the various unit holders.

I don't know how many of you had a chance to read this brief.

The Chairman: I think you can assume that it has been read by every person on the committee.

Mr. Stikeman: Then I think we might turn to the figures.

The Chairman: It might be appropriate if you were to tell the members of the committee what the situation is now in your operation and what it would appear that the White Paper might do to it.

Mr. Stikeman: I will do that by using these figures as an example. These figures take the brief as we have drafted it and turn it into concrete facts based on actual experience. If you will look at the page numbered 2 at the top, you will see that it contains the effect upon the trust of the White Paper as we have described it in words in the brief. This describes it in figures. If you look at the tax payable by the trust you will see that Income of Fund under White Paper is $755,076, and under Present is $775,076, or the same. We assume you reach the position without alteration. You see, under present law, the trust, because it disperses all its revenue to its unit holders each year, pays no income tax itself. It is treated as a pipe. But under the White Paper, on the assumptions we have put at the bottom of this piece of paper, the Fund will be considered a widely-held corporation, which means that it will pay a tax of 50 per cent. The first thing to come off that $755,000 profit under the White Paper would be the $377,538, being the tax on the footing that it is a company and no longer a conduit. The withholding tax under the White Paper is the next thing that goes on, as it does at the present time under the Income Tax Act, except that today when moneys are paid out to the unit holders they are paid out at 15 per cent and the proposal is that after 1973, unless the unit holders can establish that they reside in a country that has a tax treaty with Canada, they will suffer an increased withholding tax of 25 per cent. I think we can assume that 25 per cent will bear in this case because, by the nature of the beast, most of the unit holders do not hold registered certificates but hold bearer certificates. It is very difficult, as you all know, to prove where you are or where you are not when you are not the owner of a registered certificate, which gives some inkling as to the ownership and its location. We do know, as a matter of fact, that most of the unit holders

are small European investors who have acquired them from Swiss banks and from the private brokerage firms which are the private banks in Europe, as giving them a reasonable yield—6 per cent, which was set up in 1962 and which is still not bad, plus some hedge against inflation.

The Chairman: These are in bearer form, these certificates?

Mr. Stikeman: Yes.

The Chairman: What is the procedure for identification so that you may make the distribution?

Mr. Stikeman: The money goes to the banks and it is distributed through them.

The Chairman: How does the bank identify itself as being the holder of the bearer certificate?

Mr. E. Schousboe, Manager, Canadian Realties Fund: There are detachable coupons as in the case of bearer bonds, and these are forwarded through the paying agent, which is the Royal Bank in Montreal.

The Chairman: Then the bank would know the person to whom it is obliged to distribute the proceeds.

Mr. Schousboe: The Royal Bank in Montreal would know its overseas correspondents and its overseas correspondents would then know the invididual client, and it would perhaps there be possible to establish the identity.

The Chairman: It would be possible for the bank to certify who the real owners are.

Mr. Schousboe: It would be, but the problem is, of course, that the owners of these certificates are Swiss and there is no tax treaty between Canada and Switzerland so that there is no reason at this moment to set up any mechanism to trace the ownership. If in the future a treaty were entered into between Canada and Switzerland, then I suppose administrative machinery might be set up to handle this situation.

Mr. Stikeman: I don't think there is any quarrel with the withholding tax itself, Mr. Chairman. That goes to every resident of a non-treaty country. But that brings us back to my first statement that we are asking to be treated in the same way as the individual holders. As it is, it is pretty expensive, but if we had a treaty with Switzerland it would be cured in that fashion. I will speak to that in a moment, however.

If we follow the example through, we then see that the return on the certificate holder's investment is down to 2.3 per cent under the White Paper, 1968, compared to 5.3 per cent under the present, 1968, and 2.5 per cent under the White Paper, 1969, compared to 5.7 per cent as at present, 1969. So it is just about half. This does not take account of capital losses and capital gains at this stage, because capital losses are then charged against the capital of the Fund. We feel if this is intended to happen that the unit holders will certainly not be any longer content to remain vested with units that produce that low yield, and we wonder if they will retain them if they suffer a 25 per cent withholding tax.

The main burden of our submission is that a trust should not be taxed as it is proposed to be under the White Paper, namely, as a Separate entity.

If you would care to see the effect upon an individual owning a direct interest in Canadian real estate, let us say through a carefree lease, a net-net lease rather than as a unit in this trust, Mr. Kinghorn has kindly worked out some figures on that. If you wish to take a pencil and put in the figures on the left-hand side, between the words and the figures under the heading of White Paper on this piece of paper, you will see that we start off with the same income but we don't pay any tax of 50 per cent because it goes straight out, less, of course, the 25 per cent withholding tax which in that case would be $188,000, leaving $566,000 for a yield of just about 5 per cent to the non-resident. In other words, under the system at the present time the unit holder will get about 5.7 per cent on his investment whereas under the Whtie Paper proposal with the 25 per cent withholding tax, he would get 2.5 per cent, while an ordinary individual under the White Paper holding the same type of investment would get 5 per cent. And we are saying we think it was perhaps inadvertent to tax trusts as if they were widely-held corporations, because they are only pipelines through which the unit holder who is a member of the group has an interest in Canadian real estate. That about summarizes the position we have put into the three pages of the submission.

Now, that is very simple, but it is pretty drastic for the trust and we have said in our submission that we have come to the conclu-

sion that if the White Paper did continue to retain this proposal and it looked as if it was going to enact into law these provisions, our unit holders would certainly want us to liquidate the trust, sell the assets and disburse the monies.

The Chairman: If you were to wait until what I call D-Day, you might have a capital gains tax on that.

Mr. Stikeman: The valuation would drop so much that it would be very tough to get rid of it.

The Chairman: You could reduce the impact if you could continue to acquire capital assets.

Mr. Stikeman: We think the capital cost charges where you put every building in excess of $50,000 into a separate class, while they are taken into account in these figures, would affect us very adversely in the future.

The Chairman: You have not reflected that in the figures.

Mr. Stikeman: No, because it does not hit us in 1969, and we felt it would be unfair to push it to an extreme position.

Senator Laird: But in future years the situation would be different.

Mr. Stikeman: In future years it would have a very adverse effect on us if we sell them off and get taxed on the capital building by building.

Senator Phillips (Rigaud): I think we can leave aside for the moment the problem involved in capital gains and capital loss because it only confuses the issues and because we have no capital gains tax at this stage. I would like at this stage to confine myself to two questions. The first has to deal with your objection to the trust being assimilated under a Canadian corporation and secondly dealing with the last paragraph of your brief on page 3 where you say:

> It is for the foregoing reasons that the management of Canadian Realties Fund has concluded that, if the White Paper proposals are not modified at least so as to place it in the same position as that of a direct investor in Canadian real estate, the Fund will have to be wound up as soon as possible.

Now, on the issue as to whether the trust is or is not analogous to a company or whether it is an entity in law, you know that these problems have arisen frequently and judicial decisions are many. Assuming for the sake of argument that a trust should not be considered analogous to that of a corporation, do you not think that non-resident certificate holders in the trust should be deemed to be co-owners of property in Canada and taxed in the normal way as if they held a percentage of the ownership of a capital asset in Canada rather than receive what appears to be the preferential treatment now accorded to them as opposed to Canadian residents. After all, in the final analysis you have a management corporation functioning in Canada, and this corporation is acting on behalf of non-residents, and the non-residents remain qualified as non-residents of Canada even though their agent is a management corporation in Canada. I think you would agree that that is rather an anomalous situation and can only be justified on the basis of a parched country inviting foreign capital in. This brings up the question as to whether this invitation to foreign capital should justify preferential treatment not accorded to a domestic taxpayer. Leaving the economic factors aside, I personally entertain the view that a non-resident should not enjoy the status of a non-resident when it has an operating Canadian Company managing the capital asset on its own account, but I do agree the trust should not be assimilated to a Canadian corporation, but rather that the certificate owner should be regarded as a Canadian owner of a Canadian asset.

Mr. Stikeman: I am inclined to agree with you, and I think you have stated the distinction very well. At the present time the non-resident owning Canadian real estate directly is taxed at only 15 per cent and I gather your question is whether it would be sounder for him to be taxed as if he were a resident for that particular purpose. At the present time he is entitled to make an election under section 110 in which case he can take his exemptions and depreciations and choose between the gross 15 per cent or the personal rate. I would see nothing wrong in that on assets up to a certain level. But what we have to do, and it is logical under the present act perhaps, is to suggest that perhaps the option might be removed, that is the option that the non-resident now has of picking the lower of 15 per cent with no deductions or his own personal rate after deductions.

Senator Phillips (Rigaud): My feeling is that if a non-resident is coming into Canada

and investing in capital assets in Canada, where you have the continuing problems of management, he should be deemed to be a resident in respect of the revenue resulting from that with all the benefits that a domestic resident has. He should be in no better and no worse a position.

Mr. Stikeman: I do not think there is any quarrel with that. We are merely asking that we be treated in the same way.

Senator Phillips (Rigaud): Personally, I feel that a non-resident who comes into Canada, becomes an owner of property either through condominium or co-ownership and has a management corporation effectively administering his capital, is really doing business in Canada in respect of that particular asset.

Senator Laird: You would not remove the option?

Senator Phillips (Rigaud): I would. I would treat him on the same basis as a Canadian owner of property in respect of that income.

Mr. Stikeman: I would imagine this could become almost academic because with the 50 per cent rate, taking into account exemptions and deductions, you might well arrive at the same conclusion as if you were to choose 15 per cent of the gross.

Senator Phillips (Rigaud): But it is a matter of being logical. A trust is basically a conduit for the channeling of funds rather than a corporate entity in itself. Therefore I suggest that these people from a taxation point of view should be in no better and in no worse a position than a resident of Canada.

Mr. Stikeman: Well, you are asking me the question as a tax counsel. My own answer is one thing, but I had better ask my client what he thinks.

Senator Phillips (Rigaud): I am not attempting to embarrass you; I am expressing my opinion to you.

Mr. Stikeman: I do not think there would be much difference if we had the 50 per cent rate. What do you think, Mr. Schousboe?

Mr. Schousboe: I think it is, in the context of this particular organization, a practical impossibility to implement the solution proposed, Senator Phillips. It would require each unit holder to file an income tax declaration and calculate his Canadian income tax with respect to this income.

Senator Phillips (Rigaud): That could be done by the management corporation. I am saying for the purposes of tax liabilities it is deemed to be subject to tax in Canada...

Mr. Stikeman: It would be the formula applied to revenue going out.

Senator Phillips (Rigaud): The computation of income on a rational principle.

Mr. Schousboe: I would agree with the logic of it.

Senator Phillips (Rigaud): I think the only justification is the inducement aspect, and there is a lot to be said for that, but that is another matter not before this body in dealing with the White Paper.

The Chairman: Except that the White Paper has admitted in various places it recognizes inducements for foreign capital to come into Canada are necessary things.

Senator Phillips (Rigaud): To the extent that would be a factor in the conclusions arrived at in this committee, one could completely accept the brief as presented here, but we would have to introduce that as a factor in our reasoning. If we were dealing philosophically with the Income Tax Act, there is no reason why a foreign resident invited to bring in capital by way of investment should be receiving better or worse treatment than a Canadian resident.

The Chairman: It is a sound principle. Then you propose a formula, a method of accounting.

Senator Phillips (Rigaud): But I certainly agree with Mr. Stikeman in the view—and I strongly support it, having known him for many years—of the fundamental concept of a trust not being a corporation. I think we are on sound tax and historic ground in accepting that point of view. I think we could establish it by jurisprudence.

Mr. Stikeman: I think Senator Leonard has been pushing that theory for a long time, the conduit theory of trusts in the States.

The Chairman: Are there any questions the committee would like to ask?

Senator Everett: Referring to the balance sheet of Canadian Realties Fund, is that a complete balance sheet or does that just deal with certificate holders? In other words, I do not see any equity shareholders.

Mr. Stikeman: There are no shareholders because it is a trust; this is the whole thing. The unit holders are the equity holders.

Senator Everett: What are the special certificates then?

Mr. Stikeman: Mr. Schousboe, what are the special certificates?

Mr. Schousboe: They were originally a device serving as a sales commission when the certificates of the trust were issued to the general public. The trust is an open-end mutual fund. It was sold between 1955 and 1959 to the general public through a syndicate of about 20 private banks who were entitled to subscribe to a certain number of special certificates for each 10 or 50 ordinary certificates they sold to the public. The interest in the special certificates was that it provided beneficial participation for these selling agents in the future management profits of the trust. So that the sales incentive when the units were issued was not merely the sales commission, which was not very high—the total rate was 5 per cent whereas, of course, it is normally on this continent 8, 9 or 10 per cent—but by way of compensation they looked forward to annual revenue derived from what were effectively the management fees which happens in the allocation of income to the special certificates. These are credited with 4 per cent of the gross revenues of the trust, less interest payable. Out of this are paid certain administrative expenses, a 2½ per cent fee to the management company, Secfin, which I manage, and the balance is accrued to special certificate holders and is normally distributed to them in the year when it is accrued, by and large.

The Chairman: Would the amount of that vary from the amount the holders of what I would call ordinary certificates would get?

Mr. Schousboe: It would vary quite dramatically because there would be a good deal more leverage. If the fund has a large number of certificates outstanding and a high level of income, the overhead would not necessarily rise in the same proportion. If the fund is in a net redemption position, which it has been in for the past few years, it becomes much less interesting. I believe the distribution was $4,000 last year, and if you go back three or four years I believe it was $10,000. So as this fund has reduced in importance, the attraction of the special certificates has reduced even more dramatically. While the ordinary certificate holders have been getting the same income, $3.20 for the last few years, it has been going down for special certificate holders.

Senator Everett: Who enjoys the gain or suffers the loss on the value of the profit?

Mr. Schousboe: The ordinary certificate holders.

Senator Everett: How do you credit or debit them? You have a bearer certificate with coupons. What do those coupons say on them?

Mr. Schousboe: I could not frankly tell you.

Senator Everett: Are they for a specific amount?

Mr. Schousboe: They are an income distribution coupon, and the management company declares late in December and June what will be the income distribution as of December 31 and June 30. This income has always been earned income, not capital gains or losses. The fund has never been a trader of its assets. We sold one building in 1961 and nothing happened again until 1968.

Senator Everett: Is that this loss here?

Mr. Schousboe: Yes. That loss is from 1969. We had a loss in both years. The real estate market has been such that buildings we have sold in the last few years have all, without exception, been sold at a loss relative to the original purchase price, and in some cases also relative to the depreciated value in the books.

Mr. Stikeman: Why do you sell them?

Mr. Schousboe: I am asked, why do we sell them. My reply is because we have redemptions of this fund and because it is an open-end mutual fund, when certificate holders want to withdraw we have no option but to reduce the assets outstanding. In these situations we select buildings in which we have a loss and which we would just as soon see disappear from our investment portfolio.

I come back to your original question, as to what do we do about capital gains and losses, and does that flow through to certificate holders. The gain or loss is recorded in the books only when realized and, in the normal course of business, we do what I believe most other mutual funds invested in shares will do, we leave the book value alone. We will occasionally make a reappraisal of the true market value of the assets. We will then compute the

difference between the book value and the market value, and arrive at, for example, a figure of $3 or $5 less than the net book value. We will then fix a net redemption price of the certificate to reflect this unrealized capital loss which is brought about by the conditions under which we work, because there are no capital gains. Only as we are forced to sell off property do we record those losses in the books.

So, the certificate holder sees his losses or gains through the value of his participation certificates, and the value of those is fixed by the management company in consultation with independent advisers.

Senator Everett: What has the record of the value of your certificates been over the last three or four years?

Mr. Schousboe: The certificates were originally issued in the late fifties at a price of $50 plus a few cents. It was felt that in the early sixties the depreciation charged had been in excess of any real climb in value, so the certificate value was allowed to rise to a net asset value of about $53.

Then we came to the late sixties with higher and higher mortgage rates and certain difficulties in the Province of Quebec. Older buildings had very old mortgages on them, so that in the case of a sale they had to be remortgaged at much higher rates of interest. This has been reflected in the net asset value of the certificates.

In January, 1968 we made a reappraisal and lowered the price from $52 to $43.60, if I remember correctly.

During the last few months of 1969 there were additional redemptions of certificates, and while we have felt that the appraised value as of today is certainly less than the long term market value of the assets, we have to take into consideration the fact that we are selling under very unfavourable conditions, and we must protect the interests of those who stay in the fund.

Over the last few months of last year, 1969, there were further redemptions. In order to be able to arrange the cash necessary to meet these redemptions without being under undue pressure we have suspended the redemption of certificates. Thus, we would not be unduly harrassed while attempting to dispose of assets at acceptable prices. I would not want to second-guess the findings of our experts, but in very rough terms I would think that we will experience an additional 10 per cent or 15 per cent decline in the net asset value. This is due to the fact that on $15 million of assets we have existing mortgages of only $3 million or $4 million, so we have a large equity which anybody who buys on the market has to finance at the rate of 10½ to 11 per cent.

Senator Everett: So, a certificate with a par value of $50 will probably end up at around $38?

Mr. Schousboe: It will be something like that.

Senator Everett: Would you tell me what depreciation rate you apply?

Mr. Schousboe: It is about 1½ per cent or 2 per cent.

Senator Everett: Have you a formula?

Mr. Schousboe: No, but we have an approximation that we have set up. It was based on the assumption that the depreciable assets would depreciate over a period of 35 years calculated on the same basis as the amortization of a mortgage, so that the first year's depreciation was fixed in such a way that the money invested was assumed to earn 5 per cent, and so on from year to year.

Senator Everett: Is this what they call the compound method of depreciation?

Mr. Schousboe: Yes, possibly so. This is an approximate rate of depreciation that was fixed for the fund, but, of course, we could never arrive at a reasonably steady and meaningful pay-out rate because we would have all sorts of broken amounts to pay out. Therefore, the amounts have been kept fairly stable, but the statement of our account by our auditors shows that the total of depreciation as of today is within the range of the depreciation schedule over the 35-year period.

Senator Everett: When you sell a building do you apply the recapture to income, and the capital loss to your fund?

Mr. Schousboe: No, the depreciation recapture is passed over to the assets in the fund.

Senator Everett: So it is all part of the capital loss or the capital profit?

Mr. Schousboe: Yes.

Senator Phillips (Rigaud): I should like to put one question to Mr. Stikeman, and then

make an observation. Mr. Stikeman, on page 2 of your brief you say:

> Under the White Paper, the proposed treatment of this type of trust will be much more adverse to the certificate holders than the present law. In fact, it is safe to say that if the White Paper provisions are implemented in this respect, Canadian Realties Fund will have no option but to immediately liquidate and distribute its assets and cease operations in Canada.

My question is: Is the decision as to the necessity or desirability of winding up the corporation vested in the management or in the certificate holders?

Mr. Stikeman: I think it rests with both, but I should like to ask Mr. Schousboe to answer that question.

Mr. Schousboe: That is correct. It rests with the certificate holders in that they have the right to turn in their certificates for redemption. They cannot force us to wind up the whole fund, but they can force us to redeem their particular certificates and that, of course, could bring about a dissolution of the fund. If we reach the point where the net return after taxes is but two and a fraction of one per cent, then it goes without saying that the redemptions will be heavier than they are at present.

In the second place, the management company also has the right to declare a trust in liquidation, in which case we force the hand of all investors, and we cease the redemption of the certificates as of that date. We sell the assets as best we can, and we can distribute these assets either when they are all turned into cash, or as we go along turning them into cash.

Senator Phillips (Rigaud): Can we as a committee accept with the utmost seriousness your statement that if the White Paper provisions are implemented, having regard to your relationship to the certificate holders, you would not be able to carry on in Canada.

Mr. Schousboe: There is not a living chance that we would be able to carry on.

Senator Phillips (Rigaud): From my own personal knowledge, that opinion has been arrived at by other funds. I agree with your argument. If these provisions are implemented Canada will definitely be facing a very substantial export of capital running, in my opinion, to an amount in excess of $100 million.

The Chairman: Are there any other questions?

Senator Leonard: I have just one question, Mr. Chairman. I take it from the presentation that the case we have before us is really one with respect to foreign investment. If the trust in question were a trust of Canadian certificate holders only, then this presentation would not have been made?

Mr. Stikeman: That is substantially correct, Senator Leonard, because you do not have under the White Paper the flow-through of the tax credits to a foreign unit holder that you do in the case of a corporate shareholder.

Senator Leonard: So the crux of this particular presentation is based upon an international aspect—the aspect of foreign investment in Canada.

Mr. Strikeman: Yes.

The Chairman: Are there any other questions? If not, then on behalf of the committee, Mr. Stikeman, thank you very much for your presentation.

Mr. Stikeman: Thank you for your courtesy, Mr. Chairman. We have learned a lot too.

The committee adjourned.

APPENDIX "A"

SUBMISSION ON TAX REFORM BY THE INVESTORS GROUP

The Investors Group, either directly or through its subsidiairies, issues investment certificates and sells and manages mutual funds and pension plans. Our companies act on behalf of 180,000 mutual fund investors, 130,000 investment certificate clients, and pension funds with assets of approximately $200,000,000.00.

We are pleased to have been invited to submit our views to this Committee on the matter of tax reform. We believe that public hearings of this nature give the Government the best chance of passing fair and equitable legislation which will be practical and acceptable for all concerned.

Our submission will deal with the following matters:

I. Taxation of Mutual Funds and Their Shareholders.

II. Inequitable Effect of Certain Proposals.

III. Taxation of Foreign Income of Canadian Subsidiary.

IV. Expenses Incurred in the Course of Earning Dividends or Capital Gains From a Widely-Held Canadian Corporation.

V. Five Year Revaluation of Widely-Held Canadian Shares.

VI. Disallowance of Convention and Entertainment Expense.

I. TAXATION OF MUTUAL FUNDS AND THEIR SHAREHOLDERS

We, The Investors Group, have worked through The Canadian Mutual Funds Association to propose an equitable system of taxation for Canadian mutual fund shareholders. On behalf of the 180,000 shareholders in mutual funds under our management, we strongly endorse the submission presented by The Canadian Mutual Funds Association. Our primary concern is that these people should receive equitable tax treatment. We do not wish to duplicate the submission of the CMFA, only to emphasize the importance of that submission for hundreds of thousands of Canadians from all walks of life.

If the Government of Canada truly intends to encourage broad participation by Canadians in equities, they will do nothing to discourage the growth of mutual funds.

II. INEQUITABLE EFFECT OF CERTAIN PROPOSALS

A basic principle of new tax legislation at any time is that it should not unduly affect rights created by contracts and commitments entered into prior to the announcement of a tax change. The Government has recognized that new taxes should not apply to income earned in prior years. At page 7 of the Proposals for Tax Reform it is stated that "Individuals and businesses must be able to plan their affairs sensibly, particularly in making investments that yield a return for many years. This need for stability also implies that reforms should not include retroactive changes, applying to incomes earned in previous years."

The Proposals for Tax Reform do, however, offend this principle in several respects. The areas with which we are cocnerned are

(a) taxation of investment contract holders,

(b) taxation of recovery of capital losses incurred prior to Valuation Day, and

(c) taxation of undistributed income accumulated prior to imlementation of tax reforms.

II (a) Taxation of Investment Contract Holders

It is not our intention to argue that it is essential to retain any particular feature of the present tax system. We intend to demonstrate, however, that the abrupt recission of Section 35 of the Income Tax Act will disrupt the savings plans of many people with modest savings goals.

In order to understand how this may happen, it is necessary to examine the nature of the investment contract and the purpose of Section 35 of the Income Tax Act.

The investment contract is designed to provide persons with a means of accumulating a worthwhile sum of money. The Canadian Committee on Mutual Funds and Investment Contracts reported that "many investment contracts are sold on an instalment payment basis, with monthly payments in dollar amounts of from $4.00 to, rarely, $40.00 or more. In an extensive sampling of such investment contracts, we found that 62 per

cent of them called for monthly payments of $15 or less, and 80 per cent of them called for monthly payments of $25.00 or less. These figures show clearly that the class of investor for which these contracts are tailored includes persons in a comparatively low income bracket who wish to save by putting aside a small amount of money each month".

Many of these contracts represent the only savings some low income people will ever have. The amounts involved, by the personal standards of the men designing the tax law, ourselves, and no doubt the gentlemen on this Committee, are rather small. $15.00 per month paid into a plan for fifteen years will result in an accumulation of about $3,600, which represents a profit of $900.00 or $60.00 for each year of regular, patient savings.

What is $3,600? It may be a university degree. It may be a down payment on a house. It may be security in retirement. We do now know how the money is used. We do know that people in the low income brackets find it difficult to meet the cost of living and it requires some considerable sacrifice to save any money. The Government recognized the need to encourage regular savings by providing an averaging section (Section 35 of the present Income Tax Act and Section 33A of the 1948 Income Tax Act). The averaging process recognized the fact that the earnings arose over many years and that it would be unfair to tax all of the income in one year at the marginal tax rates which apply to additional income earned. The averaging provisions contained in the Proposals for Tax Reform will not apply to the average certificate holder because his gain on the contract will usually not exceed one-third of taxable income. They can only benefit those who are able to invest relatively large amounts. The average certificate owner, therefore, will be given no incentive to save money even though a large percentage of them do not save money in any other way.

Our arguments for retaining Section 35 are supported by The Canadian Committee on Mutual Funds and Investment Contracts which at paragraph 18.34 of their report state: "In our view, there are strong arguments of *equity* to support the application of a spreading provision such as Section 35 of the Income Tax Act". This Committee examined investment contracts in depth over a three year period and is no doubt in an excellent position to comment on all regulations affecting investment contracts.

In looking at Section 35, the special situation of investors in savings certificates should be considered. Of great concern to us are those who have purchased investment contracts on the understanding that their investment gain would be subject to tax at a special rate. This incentive, introduced in 1951, has been an important factor in encouraging people to buy investment contracts. Withdrawal of the incentive as proposed will retroactively penalize those people who have been saving money for as long as 18 years. They will be forced to pay a much higher tax than was anticipated at the time the contract was taken out. On those certificates where an accumulated profit has arisen, the failure to realize this profit prior to implementation of the new Proposals would mean that a higher rate of tax would be levied on past accumulation as well as on future gains. There is thus an unintended incentive for contract holders to terminate their savings programs in order to avoid the penalty associated with tax reform.

The abrupt termination of Section 35 would therefore create problems for companies such as Investors Syndicate Limited and The Western Savings and Loan Association. Inflation has already made it difficult to sell guaranteed savings plans as people want to buy equities instead. A greater number of people are also surrendering their contracts. If Section 35 were to be removed there would be the additional pressure to surrender contracts prior to the effective date of the removal. The present would be a particularly inopportune time for us to draw on our reserves to meet surrenders. We have invested heavily in government bonds and mortgages. Government of Canada bonds are not marketable in large amounts and can be sold only at a deep discount. It is virtually impossible to dispose of mortgages. We are confident that the Government does not intend to combine deliberate action through tax changes with the pressures of inflation and high interest rates to embarrass firms which have invested in long-term bonds and mortgages.

The revenue gain to the Government in terminating the averaging provisions of Section 35 would be very small as the total net earnings of all certificate holders in Canada is only about $12,000,000 annually. From this total we must eliminate the portion attributable to non-residents, corporations, and registered retirement savings plans, and gains received through instalment or annuity settlements, as Section 35 is not applicable to any

of these cases. The revenue gain is probably under $2,000,000 per year.

If revenue gain is in fact the primary concern, we are willing to work with the Government to amend Section 35 to prevent any abuses which may be possible. With our years of experience in issuing investment contracts, we have encountered many attempted abuses. We have consistently discouraged any practice which we felt was an abuse.

Finally, there is a real social loss as well in discouraging guaranteed savings programs. The Economic Council of Canada has pointed out that our need for savings, particularly investment in new housing, will be greater in the next six years than in the past decade. Life insurance companies and investment contract companies, the two industries to which Section 35 applies, are major sources of mortgage funds. These sources would be adversely affected if Section 35 is removed.

II (b) Taxation of Recovery of "Capital Losses" Incurred Prior to Valuation Day

It appears to be particularly unfair to levy a tax on the sale of an investment at its original cost simply because the value of the investment at a selected interim date (Valuation Day) was less than cost. We do recognize that it is impractical to allow a deduction for a loss occurring before Valuation Day but it should be possible to tax only gains in excess of cost and allow a deduction for losses only where the proceeds are less than market value on Valuation Day. To tax the recovery of a non-deductible decline in market value is to confiscate capital and can have no support in equity.

Specifically, persons who buy contractual savings plans in mutual funds pay a larger part of their costs in the first year than in subsequent years. Therefore the market value of their shares will normally be less than cost in the early years of their savings program. Under the Proposals for Tax Reform the recovery of these costs would be taxed.

This type of savings plan, and mutual fund investment in general, will be discouraged until after Valuation Day unless some provision is made. We, as a company, must in fact consider whether or not it is ethically right to persuade people to invest money prior to Valuation Day. If we stop selling we would lose nearly all of our sales force, as they are paid by commission. This would be harmful not only to us but also to Canada. The Canadian Committee on Mutual Funds and Investment Contracts concluded that mutual fund salesmen served a useful purpose in that they promoted the widespread ownership of equities among people who would otherwise not seek out that form of investment.

Another problem which arises out of the Valuation Day concept relates to the valuing of control holdings in subsidiary companies. At valuation date those companies which hold substantial interests in subsidiaries or affiliates should be permitted to value their shares at fair market value, rather than the trading price on that particular day. This principle is recognized in the Estate Tax Act. An exception to the general rule that shares in public companies should be valued at the closing price on the stock market on Valuation Day is therefore required. The need for specific consideration arises from the fact that control of a public company must usually be obtained by a general offer to all shareholders. In order to interest the existing shareholders in selling, the purchasing company must offer a price well in excess of then current market value. For example, when The Investors Group bought 50.1 per cent of Great-West Life in 1969, the offering price was about 25 per cent higher than market price at that time.

II (c) Taxation of Undistributed Income Accumulated Prior to Implementation of Tax Reforms

It is proposed that upon distribution of any undistributed income and hand prior to implementation of tax reform, the payor company should pay a tax of 15 per cent and distribute the balance as a return of capital to the shareholders. The purpose of this proposal is "to ensure that the taxes which would become due under the existing tax system are not forgiven" (Para. 4.78).

Taken together with reduction of top personal tax rates and full integration of taxes paid by closely-held corporations, this proposal is attractive for many large closely-held corporations and their more wealthy shareholders. It is a particularly onerous provision, however, for:

(i) low income taxpayers,

(ii) registered retirement savings plans, pension plans, and tax exempt charities or organizations, and

(iii) widely-held Canadian corporations.

These persons pay virtually no tax on dividend income now so there is no chance that

"taxes which would become due under the existing tax system" are being forgiven. The proposal is particularly inequitable for a business carried on by a parent corporation and its wholly owned subsidiaries. It may be necessary or practical to operate a business, essentially under one management, through several corporate entities due to various government regulations or for sound business reasons. The business is essentially a single unit and it is inappropriate to levy a tax on the transfer of income from a subsidiary to a parent by way of dividend.

It is, of course, possible to avoid the tax by having all undistributed income paid out in 1970 but there will be situations in which the subsidiary is unable to do this due to a restriction in bond indentures, other loan agreements or government regulations.

It would seem preferable to provide that undistributed income accumulated under the present system should be distributed as "old surplus dividends" eligible for the 20 per cent dividend tax credit or tax exemption and deductible from the cost for capital gains tax purposes. This type of provision might be more complex to handle but it would achieve the following:

(i) reduce the advantage for wealthy individuals without penalizing them. The reduction of the top rate of tax to 50 per cent would limit their liability to 30 per cent on cash dividends and Sec. 105 distributions would still be available.

(ii) provide the same after tax return from old surplus for low income shareholders as they would get today;

(iii) continue the exemption on dividends passing between Canadian corporations, thus avoiding disruption of existing corporate arrangements and capital structures.

The administrative problems of following old surplus dividends through various corporate levels would be no greater than those of following tax paid surplus through the same chain. It would also avoid the dilemma in which widely-held corporations with large corporate shareholders would find themselves. The majority shareholders might want special dividends, perhaps stock dividends paid in 1970. These large special dividends would be exempt to pension trusts and corporate shareholders but taxable at today's high marginal rates for other shareholders. This would force directors of many large companies to choose between shareholders.

III. TAXATION OF FOREIGN INCOME OF CANADIAN SUBSIDIARY

We believe that it is essential that income be permitted to pass freely between corporations, particularly income passing from a subsidiary to a parent. Many subsidiaries have been formed to carry on a branch of the parent company's operations. There are sound business reasons for doing so. The proposed tax treatment of subsidiaries will interfere with normal business operations.

A Canadian corporation will be able to receive dividends tax free from subsidiaries in tax treaty countries. But such dividends will not necessarily pass tax free if the subsidiary is Canadian. If the subsidiary is incorporated in Canada and carries on its foreign operations as a branch, the parent company will be taxed on dividends paid out of the subsidiary's foreign income. This difference in tax treatment due only to a change in place of incorporation is not logical and does not produce horizontal equity for companies in similar situations.

It will be possible for some of the parent companies involved to carry on the foreign operations in their own name, but this is not always feasible. For example, The Great-West Life Assurance Company in which we have a 50.1 per cent interest, carries on a substantial operation in the United States. It is not possible for The Investors Group itself to carry on a life insurance business and it is not practicable to reorganize Great-West Life in order to carry on the U.S.A. operation though a separate company. Even if it were feasible, it seems inequitable that those who can afford complicated and costly reorganizations should be able to achieve tax savings while others who lack the resources could not.

The Government is apparently leaving companies such as Great-West Life no reasonable alternative but to retain foreign earnings if the shareholders are not to be penalized. In a case where the subsidiary is wholly owned, there would be a tax on the transfer of foreign taxed income by way of dividend from the subsidiary to the parent. This simply does not recognize the underlying facts and amounts to a tax on form, rather than substance.

Taxation of form has always given rise to difficulties and leads to tax planning devices which emphasize form rather than substance.

A simple solution would be to permit the transfer of income from a subsidiary to a parent without tax. The tax free distributions would have to be from income earned after control was acquired. This would permit a corporation to carry on its activities in a business-like manner, with or without subsidiaries. The creditable tax of subsidiaries would be passed on to the parent when dividends were paid so there would be no tax advantage or disadvantage to the shareholders of the parent company. Minority shareholders would receive credit for their proportionate share of creditable tax and so they too would not be affected.

IV. EXPENSES INCURRED IN THE COURSE OF EARNING DIVIDENDS OR CAPITAL GAINS FROM A WIDELY-HELD CANADIAN CORPORATION

Canadian tax policy has been to disallow expenses incurred to earn income which is tax-exempt. This policy has led to major problems in allocating expenses against various forms of income—some of which are fully taxable, some of which are tax-exempt. These problems have been aggravated by the absence of definite guidelines and different taxpayers have made special arrangements with the Department of National Revenue. Considerable credit is due the Department for its attempts to arrive at settlements which are reasonable to both the taxpayer and the Treasury. Nevertheless, it is an unsatisfactory situation where business is unable to plan its affairs without resorting to a bargaining process with the tax collector.

The intent of the Proposals for Tax Reform in this area is to levy a special rate of tax ($33\frac{1}{3}$ per cent) on income which has been formerly exempt from tax—dividends and capital gains. Since these sources of revenue are now to be subject to tax, it is reasonable to assume that expenses incurred in earning dividends and capital gains will be treated as legitimate deductions for tax purposes. However, because the proposed rate of tax differs from the normal corporation tax rate, the problem of allocating expenses will continue unresolved.

The disadvantage vis-à-vis American competition in such matters as financing the acquisition of Canadian corporations is a direct result of the disallowance policy. There are other examples where investment policy has been distorted in order to avoid undue disallowance of expenses in the investment program.

We do not have a simple solution to this matter but we strongly urge that when the appropriate legislation is introduced there should be reasonable guidelines established for the allocation of expenses. At a minimum this will enable business to carry out forward planning against a background of known factors.

V. FIVE YEAR REVALUATION OF WIDELY-HELD CANADIAN SHARES

We understand from press reports that widely-held Canadian companies will not be required to revalue their holdings of widely-held Canadian shares every five years. This is not clear, however, from the Proposals for Tax Reform. It would not be sensible to require a revaluation in these circumstances. The amounts included in income upon revaluation by the shareholders of a holding company would include or reflect increases in the value of a holding company's investments. We expect, therefore, that widely-held Canadian companies would not revalue their interests in other widely-held Canadian companies.

In any event, we do not believe that the five year revaluation is necessary to avoid the "lock-in" effect. This "lock-in" occurs in the United States because the heir to property takes probate value as his cost so the capital gains tax is never paid if property is held until death. There is an incentive then for older people to hold property which has appreciated, even if potential further growth is minimal. The proposal to permit an heir to use only the cost to the deceased would avoid this problem.

If there is a "lock-in" effect without the five year revaluation, the adverse effects would be considerably less than those caused by the revaluation. Revaluation may cause persons who now control public corporations to lose control. As the control factor carries an additional value, the individual involved may easily be open to a take-over offer which includes a bonus over current market value. Any attempt to sell a large portion of a company's stock could deflate the market price of that stock. The choice may be between selling some shares at less than a normal price or selling all of the shares held at an above normal price. This could increase foreign ownership in medium sized public corporations.

This revaluation is a further deterrent for private companies which may otherwise go

public. The main deterrent, of course, is the reduction of corporate tax integration. Together, these two factors will encourage the perpetuation of family interests and thus impede the goal of having widespread participation in Canadian equities.

VI. DISALLOWANCE OF CONVENTION EXPENSE

We believe it is unreasonable to disallow convention expenses that can be shown to have a business purpose. Our company uses conventions and seminars to educate, instruct, and inspire the sales force. We believe that our conventions are productive and a necessary part of our business operation.

There is already provision in the Income Tax Act which permits the disallowance of unreasonable expenses. In order to eliminate or discourage abuses, it is only necessary to effectively enforce the law that already exists. In those cases where difficulty may be encountered in determining what is and what is not reasonable, recourse can be had to the Courts.

SCHEDULE I

15 YEAR INVESTMENT CERTIFICATE—$15.00 PER MONTH PLAN

End of Certificate Year	Total Amount Paid In On Monthly Basis	Guaranteed Value	Projected Additional Credits	Total Projected Value	Gain (Loss) to Surrender
	$	$	$	$	$
1	180	—	—	—	(180)
2	360	174	3	177	(183)
3	540	354	8	362	(178)
4	720	543	16	559	(161)
5	900	738	28	766	(134)
6	1,080	945	43	988	(92)
7	1,260	1,158	62	1,220	(40)
8	1,440	1,377	84	1,461	21
9	1,620	1,611	111	1,722	102
10	1,800	1,854	142	1,996	196
11	1,980	2,106	178	2,284	304
12	2,160	2,370	219	2,589	429
13	2,340	2,643	265	2,908	568
14	2,520	2,925	317	3,242	722
15	2,700	3,225	375	3,600	900

APPENDIX "B"

Name of Company: THE INVESTORS GROUP

ANALYSIS OF APPENDIX "A" BY SENIOR ADVISOR

This brief refers to a widely diversified group of subjects some of which relate directly and some indirectly to the White Paper.

The submissions made in the Brief may be grouped under the following arbitrary headings

A Grossing-up of Canadian Dividends.

(i) 15% Tax on undistributed income (Page 10 of Brief)

(ii) Foreign income of a Canadian subsidiary company (Page 13 of Brief)

B Taxation of Capital Gains

(i) Valuation of shares on Valuation Day (Page 8 of Brief)

(ii) Five Year Revaluation of Shares (Page 18 of Brief)

C Other Matters

(i) Taxation of Mutual Funds (Page 2 of Brief)

(ii) Taxation of Holders of Investment Certificates (Page 4 of Brief)

(iii) Expenses incurred to earn Exempt Income (Page 16 of Brief)

(iv) Entertainment and Convention Expenses (Page 20 of Brief)

There is attached a summary of present legislation, White-Paper proposals and the principal points of the Brief in the sequence followed in the Brief.

Name of Company: The Investors Group

Principal Subject: Taxation of Mutual Funds

Present Tax Law	*White Paper Proposals*	*Principal Points of Brief*
Section 28-1 of the Income Tax Act. Most mutual funds are incorporated companies and required to pay annual taxes on any taxable income received by them. The above section permits taxable income to be reduced in respect of dividends received from other Canadian companies or from foreign companies in which the fund owns more than 25% of the voting stock.	Chapter 4 of the White Paper proposes that all Canadian corporations must pay an annual corporation tax of 50% (40% to federal government and 10% to provincial governments) to ensure that shareholders thereof may receive a dividend credit on dividends paid by such corporations The specific references to mutual funds are: 4.61 Open-end mutual funds and most closed-end mutual funds would be widely-held corporations under the definitions proposed earlier in this chapter. As a result shareholders would receive the dividends that flow through the mutual fund subject to the same tax as if they had received the dividends directly. There is one exception to this, in the case of dividends from a closely-held corporation that are routed through a mutual fund. In this instance the government feels it appropriate to levy the same taxes on the portion of the corporate income as if the earnings had been in a public corporation. The relationship of the shareholder of the mutual fund to his corporation is much the same as that of shareholders of other public corporations to their corporations.	*Page 2 of Brief* This portion of Brief makes no specific comments respecting the taxation of mutual funds and their members or shareholders. The brief endorses the submission of The Canadian Mutual Funds Association.
Section 38-1 of the Income Tax Act. Section 6-1-a of the Act requires a Canadian shareholder to include in his income subject to tax all dividends received. The above section permits a Canadian individual to deduct from his income tax 20% of dividends received from almost all Canadian companies, including incorporated mutual funds.	4.62 A special rule would, however, be required for mutual funds. This type of corporation must be able to put its shareholders in the same position as if they themselves had realized their proportion of the capital gains of the mutual fund arising on the sale of shares in public Canadian corporations. In the absence of a special provision mutual fund shareholders would pay tax on the full amount of such gains when they were distributed to them, whereas tax should be applied only to half of the gain. Consequently this type of corporation would	

be enabled to make special distributions to its shareholders which would be treated as though they were a capital gain on the sale of a Canadian public corporation. The effect of this proposal is illustrated below:

	Mutual Fund	*Individual Shareholder*
Gain on sale of shares	$300	$300
Tax:		
At $33\frac{1}{3}\%$ on the gain	100	
At say 40% on one-half of the gain		60
Net gain	200	
Special dividend distributed to shareholders	200	
Taxable credit	100	
Taxable amount	300	
Gross tax, at 40% on one-half	60	
Less credit	100	
Refund	40	
Net amount retained		
Dividend plus refund	$240	
Gain less tax		$240

Name of Company: The Investors Group

Principal Subject: Taxation of Holders of Investment Certificates

Present Tax Law

Section 7-1 of the Income Tax Act.

This section provides that when an amount is received by a taxpayer that can reasonably be regarded as being in part a repayment of capital and in part a payment of income, the taxpayer must include the element of income in his income which is subject to tax.

White Paper Proposals

The White paper appears to make no recommendation in respect to the removal or retention of Section 35 of the Income Tax Act which relates to the right to average Tax on the income element contained in combined capital-income receipts.

However it does recommend the removal of Section 36 of the Income Tax Act which relates to similar averaging of tax on pension payments, retirement allowances, profit-sharing plans, deferred profit sharing plans and death benefits.

It is therefore a reasonable inference that the removal of Section 35 of the Income Tax Act may be contemplated by the White Paper.

The White Paper does propose a new averaging formula for all taxpayers in the following paragraphs:

2.55 The government has reached the view that a general averaging formula should be available to all individual taxpayers. However, it proposes a much simpler and more automatic system than the royal commission did. Averaging would introduce new complications for the taxpayer, and new need for keeping records. Moreover, the system proposed by the commission would confront the taxpayer with difficult choices, and the possibility of choosing a period that would later prove to be against his own interest. The proposed simpler method can be applied automatically by the central tax assessment computer, using the information for previous years stored in its memory. Moreover, it would work smoothly and fairly even when tax rates change. It should also be noted that

Principal Points of Brief

Pages 4 to 8 of the Brief

This portion of the Brief states the case for the retention of Section 35 of the Income Tax Act.

averaging options can be very expensive in terms of revenue, particularly at a time when incomes are growing rapidly, and there must be safeguards against giving the benefits of averaging to what are simply growing incomes.

2.56 The method proposed is as follows: when the income in the taxation year exceeds the average of the taxpayer's income in the preceding four years by more than one-third, the excess income would be taxed as though it were subject to a graduated rate schedule in which the income brackets to which each rate applied were five times as wide as normal. The formula is necessarily complicated but this would not concern taxpayers because it can be applied on their behalf. Tables 11 and 12 show the application of the formula in more detail.

2.57 It is not proposed to remove the present averaging formula for farmers or fishermen, who would be free to use either system. But a year included in a block of years averaged under the present system could not be used in applying the proposed new formula. Current provisions permitting averaging over a period for special lump-sum business receipts from recaptured capital cost allowance, inventory revaluation, the sale of inventory and the sale of receivables would be phased out. For corporations the phase-out would begin once the transition to one rate of corporate tax is complete. Lump-sum payments out of pension funds, or from employers on retirement, could be averaged on the new formula or, subject to certain safeguards, paid into a registered retirement savings plan, over and above the normal limit on such payments. A similar opportunity to pay extra amounts into registered retirement savings plans might be afforded to those having certain other types of irregular or short-term incomes such as authors and professional athletes. Withdrawals from such reg-

Name of Company: The Investors Group

Principal Subject: Taxation of Holders of Investment Certificates

Present Tax Law	*White Paper Proposals*	*Principal Points of Brief*
	istered plans would be fully taxable and made on a regular and controlled basis. 2.58 It would not be possible to bring the general averaging arrangement into effect immediately. It would be necessary to have the records of assessed income for previous years for all or nearly all taxpayers before the system could be fairly used. Until this accumulation of information reaches five years it would be necessary to use a shorter series of years, with a lower "threshold level". 2.59 A second and more serious practical problem is whether years in which there is no taxable income for one reason or another should be counted for averaging, and whether years before such a year of no income should be used. It seems unfair to permit a taxpayer to include in averaging any years in which he or she is claimed as a dependant for purposes of the married exemption. The same is true of students at school or university. Counting such years of no income, or income below the exemption limit, might well reduce tax for several years on people who have chosen to be outside the labour market and in respect of whom dependants' deductions have been granted. It is therefore proposed that a married person may use for averaging only an unbroken series of years after being claimed as a dependant by his or her marriage partner. A person under 25 years of age could use only an unbroken series of years since the last year in which he had no tax to pay. These rules are not wholly satisfactory, but no simple and practical alternative has been found. Those prevented by such rules from using more than, say,	

two previous years for averaging might be permitted to assume an arbitrary income of $5,000 per year in the years excluded.

Name of Company: The Investors Group

Principal Subject: Valuation of Shares on Valuation Day

Present Tax Laws	*White Paper Proposals*	*Principal Points of Brief*
There is no reference to this proposal in the present Income Tax Act.	Chapter 3 of the White Paper proposes that capital gains be taxed as income after a date which remains to be announced. This requires that assets be valued as of a valuation date. The specific paragraphs relating to the valuation of securities follow. 3.15 The government does not propose to tax gains that arise before the new system is introduced unless those gains would have been taxed under the present system. Consequently, the general rule would be that taxpayers could deduct from the proceeds of sale of assets the value of those assets on "valuation day". Consider the case of the taxpayer who bought a block of shares in 1964 for $1,500 which today is worth $2,500. If the new system were to go into effect with today as valuation day, and if the taxpayer were to sell his shares a year from now for $2,600, his taxable gain would be only $100. If he were to sell them for $2,100, he would have a loss for tax purposes of $400. 3.16 The natural and ordinary thing to do would be to proclaim that valuation day is to be the day on which the new system is to begin. However, if that were done, the pressure on market prices on that day could be tremendous, and the opportunities for price-fixing too great. To avoid these consequences, the government proposes to choose a day close to the beginning of the system and to announce that evening that it was valuation day.	*Pages 8, 9 and 10 of Brief* This portion of the Brief states the case for valuing assets at cost where cost exceeds the value at valuation date.

Name of Company: The Investors Group

Principal Subject: 15% Tax on Undistributed Income accumulated prior to Tax Reform Proposals

Present Tax Law

Section 105 of the Income Tax Act

At the present time, Corporations are required to pay annual corporation taxes of about 52% of taxable income and have the right to pay an additional tax of from 15% to 20% or 30% on the balance of profits remaining after deducting taxes under the provisions of Section 105, to enable this remaining income to be distributed free of tax to shareholders.

This means that by paying total taxes of from 60% to 65% of its income, a corporation can distribute the balance of its income to its shareholders free of further tax.

To date, most family-owned companies have refrained from paying this additional tax on behalf of their shareholders.

Public companies cannot pay this additional tax for fear of injuring small shareholders.

Tax Reform Proposals

Chapter 4 of the White Paper professes that all Canadian corporations must pay a combined federal and provincial annual income tax of 50% to ensure that shareholders may receive a dividend credit on diivdends paid by such corporations.

With respect to undistributed income accumulated under the present tax system, the White Paper proposes:

4.78 Two provisions are proposed to ensure that the taxes which would become due under the existing tax system are not forgiven. As the earnings accumulated before the new system begins—"undistributed income on hand" to use the technical phrase—are distributed, a special 15-per-cent tax would be levied. The distribution would then be considered as a return of capital to the shareholders, offsetting part of the cost or beginning value of their shares. This procedure would continue, and extend somewhat, the existing provision concerning distributions of undistributed income on payment of a flat-rate 15-per-cent tax. Corporations could elect to treat early distributions as being of this nature and so clear up their situation.

It is interesting to observe that the authors of the White Paper have refused to estimate the amount of tax to be received under such proposals.

8.30 We expect that some corporations would take advantage of the extension of the present provision permitting tax-free distribution of accumulated surpluses on payment of a 15 per-cent tax (paragraph 4.78). However, the amounts are almost im-

Principal Points of Brief

Pages 10, 11 and 12 of the Brief

This portion of the Brief points out that the proposal in the White Paper creates hardships on low income taxpayers, pension plans and shareholders of widely-held Canadian Corporations.

Present Tax Law	*Tax Reform Proposals*	*Principal Points of Brief*
	possible to predict and could vary substantially from year to year depending upon how many and which corporations are wound up or reorganized that year, or choose to make a partial distribution of this type.	

Name of Company: The Investors Group

Principal Subject: Taxation of Foreign Income of a Canadian Company that is a subsidiary company.

Present Tax Law

At the present time, a Canadian company that carries on business in another country through a branch located there is required to include the branch profit in income subject to Canadian tax, and is allowed to deduct the foreign tax from the Canadian tax, to the extent the foreign tax rate does not exceed the Canadian tax rate.

For this reason, most Canadian companies carry on foreign operations through a foreign corporation, rather than through a branch operation.

Dividends from such a foreign subsidiary are received free of Canadian tax, so that only foreign tax is paid on the foreign income.

This fact is of considerable importance where the foreign tax rate is less than the Canadian tax rate.

White Paper Proposals

Chapter 4 of the White Paper proposes that all Canadian companies must pay an annual federal and provincial income tax of 50% to ensure that shareholders thereof may receive a dividend credit on dividends paid by such corporations.

To ensure that a 50% tax is paid on the income of a Canadian corporation that carries on foreign operations, the White Paper proposes the following:

6.23 The present tax treatment of the business profits and wages earned abroad by Canadian corporations or individuals is the same as that for portfolio investment income. The income is taxed as earned, and the taxpayer is entitled to a foreign tax credit for taxes paid to the government of the foreign country on that income. The government proposes to continue that treatment.

6.24 While the government proposes to retain the existing system of taxing foreign business profits, two important changes to the foreign tax-credit provisions are appropriate. Provisions will be put forward to prevent taxpayers from reducing Canadian tax by transferring the operation of a foreign branch which has sustained losses to a foreign company in order to avoid the Canadian tax which should ordinarily be recaptured on subsequent branch profits.

6.25 In addition, the government proposes to amend the foreign tax-credit provisions to permit the excess of foreign taxes paid over the amount creditable in a year to qualify for allowance in other years. The carry-over of the foreign tax credit is intended to alleviate the problem that arises when income is taxable abroad in a different year from that in which it is taxable in Canada.

Principal Points of Brief

Pages 13, 14 and 15 of the Brief

This portion of the Brief recommends that dividends continue to be permitted to pass between Canadian companies free of Canadian tax.

6.26 In its tax treaties, Canada will also be prepared to recognize the income taxes levied by political subdivisions of foreign countries on a reciprocal basis. If the foreign country is prepared to give a foreign tax credit for the income taxes levied by the provinces, Canada will agree to give a credit or a deduction, whichever is appropriate, for the taxes levied by its political subdivisions.

The White Paper also proposes that where a Canadian corporation receives a dividend from another Canadian company, the following rules will apply:

4.57 A widely-held Canadian corporation receiving a dividend from a closely-held Canadian corporation would be taxed on the dividend in the same way that it is taxed on other income. Specifically, the corporation receiving a dividend of $100 from a closely-held Canadian corporation would take into its income for tax purposes $200 and claim as a deduction from the corporate tax it would otherwise pay the $100 corporation tax paid by the first corporation. In effect the dividend would have been received tax-free in this situation. However, if the corporation that pays the dividend has not paid sufficient corporation tax to Canadian governments to cover the dividend, the receiving corporation would have some net tax to pay.

4.58 When the receiving corporation pays a dividend to its shareholders it would instruct them to add to the dividend for the purposes of the tax calculation only half of the corporation tax levied on it. The schedule set out below illustrates this procedure. The effect is that shareholders of Canadian public corporations receive credit for half, and only for half, of the corporation tax paid on the profits from which their corporation pays its dividends. This is true whether the profits are earned

in a subsidiary corporation or in the public corporation itself.

Dividend received	$100	$100
Plus taxable credit:		
Assuming the payor corporation had enough creditable tax	100	
Assuming that it did not have enough, say $\frac{4}{5}$ths		80
Taxable amount	200	180
Gross tax	100	90
Less credit	100	80
Net tax	0	10
Amount available for distribution to its shareholders (dividend minus net tax)	100	90
Creditable tax available (half of gross tax amount)	$ 50	$ 45

4.59 Special rules are needed to cover the case of a public corporation which receives a dividend from another public corporation. If the dividend were taxable at normal corporate rates, the effect would be to collect more corporate tax in those instances where there are intercorporate holdings than in those instances where the individual shareholder holds his share in the operating corporation in his own name. To overcome this shortcoming it is proposed that a special tax rate be applied to the dividends received by Canadian public corporations from other Canadian public corporations. The rate would be $33\frac{1}{3}$ per cent so that this type of intercorporate dividend would be tax-free provided the corporation paying the dividend had paid sufficient Canadian corporate tax to cover the dividend. This special rate would also be applied to capital gains

Present Tax Law	*White Paper Proposals*	*Principal Points of Brief*
	realized by one Canadian public corporation on the sale of shares in another Canadian public corporation. Finally, the loss suffered by one Canadian public corporation on the sale of a share in another Canadian public corporation would reduce tax only at this special rate. The effect of this rate on dividends passing through an intercorporate chain is illustrated in the following schedule:	

	Corporate Chain	*Direct Ownership*
Dividend paid by public corporation No. 1	$100	$100
Public corporation No. 2		
Dividend received	100	
Plus taxable credit	50	
Taxable amount	150	
Gross tax, 33⅓%	50	
Less credit	50	
Net tax	0	
Amount available for distribution	100	
Creditable tax (gross tax amount)	$ 50	
Individual shareholder		
Dividend received	$100	$100
Taxable credit	$ 50	$ 50

Name of Company: The Investors Group

Principal Subject: Expenses incurred in the course of earning dividends or capital gains from a widely-held Canadian Corporation.

Present Tax Law

Sections 11-1-c, 11-3a and 11-3b of the Income Tax Act

These sections provide that a corporation cannot claim a deduction for interest paid on borrowed money used for the purchase of shares of other Canadian Companies.

Section 12-1-c and Section 12-6 of the Income Tax Act

These sections state, subject to a minor exception, that a taxpayer cannot deduct any outlay or expense that can reasonably be said to have been incurred to earn any income that is exempt from tax (e.g. dividends received by one Canadian company from another Canadian company).

White Paper Proposals

The White Paper makes no specific suggestion respecting expenses incurred by a corporation to earn tax exempt income.

It could be inferred that the provisions of the present Income Tax Act are viewed with approval by the authors of the White Paper.

Principal Points of Brief

Pages 16 and 17 of the Brief

This portion of the Brief refers to the problem of expenses incurred to earn tax exempt income (usually dividends received by one Canadian company from another Canadian company) but does not offer any specific suggestions as to a solution.

Name of Company: The Investors Group

Principal Subject: Five Year Revaluation of Shares of Canadian Widely-Held Companies

Present Tax Law

There is no reference to this proposal in the present Income Tax Act.

White Paper Proposals

1.28 The government has decided to include capital gains and a number of other benefits in income subject to tax. Reviews of this subject by the royal commission and the government led to the conclusion that this is essential in order to be fair between those receiving such gains and others deriving their incomes from other sources. Moreover, the taxation of gains is essential to block loopholes effectively. The economic effects of taxing gains have been appraised and are considered unlikely to interfere significantly with incentives to save and invest in Canada.

1.29 Those who make substantial capital gains in the stock market or in real estate increase their ability to spend money just as those who earn wages or derive an income from carrying on business. Interest payments are already fully taxed. Capital gains are now widely sought as an objective in investment. Indeed the freedom of capital gains from tax is distorting the investment of savings under present circumstances.

1.30 In general we propose to include capital gains fully in income for most classes of assets whenever they are realized by the sale of such assets, and to allow realized capital losses to be deducted from income. Certain exemptions would be permitted for taxpayers' homes and for articles of personal property. Special rules would apply to the marketable shares of widely-held Canadian companies. On such shares accrued gains would be taxed every five years and accrued losses allowed as deductions at such time. Only half the gain or loss on such shares would be taken into taxable

Principal Points of Brief

Pages 18 and 19 of Brief

This portion of the brief relates solely to the proposed five year revaluation of shares of widely-held Canadian companies.

Note the opinion expressed on page 19 that revaluation will

(a) increase foreign ownership in medium-sized public companies, and

(b) prohibit widespread participation by Canadians in Canadian equities.

income in recognition that the corporation income tax paid by such companies is only partially credited for personal income tax. This is explained in Chapter 3.

3.33 Taxpayers other than widely-held Canadian corporations would include only one-half of their gains on the sale of these shares in taxable income and deduct only one-half of their losses. However, they would be required to revalue these shares to market value every five years and take one-half of the resulting gain or loss into account for tax purposes in that year. A special rate is proposed for widely-held Canadian corporations to avoid double tax. This is explained in Chapter 4.

3.34 The rule that only one-half of gains or losses would be taken into account for tax purposes would put Canadians in approximately the same tax position regarding capital gains and losses on these shares as most of the non-residents who invest in Canada. Specifically, it would put them on approximately the same footing as American individuals and corporations and British individuals and corporations. (It would be impracticable to attempt to tax non-residents on their profits on the sale of small blocks of publicly listed Canadian shares.)

3.35 The 50-per-cent taxability of such gains, coupled with the 50-per-cent credit for corporate tax paid by such corporations, should also result in a relatively balanced system in which there is little incentive for Canadians to receive their income in the form of capital gains rather than dividends, or vice versa. Again this balance is explained more fully in Chapter 4.

3.36 The proposal that the accrued gains or losses on those shares be taken into account every five years is one of two exceptions to the general rule that capital gains and losses would be taxable only

Present Tax Law	*White Paper Proposals*	*Principal Points of Brief*
	when they are realized. (The other exception concerns taxpayers who leave Canada.) Periodic revaluation would reduce somewhat the value of the half-gains rule. It would reflect the fact that these shares are readily marketable and that a taxpayer can, therefore, realize his gain or loss fairly easily at the time of his choosing. The shares of private companies do not have the same marketability. 3.37 Periodic revaluation would also reduce the "lock-in" effect that might well otherwise occur. If a taxpayer faces a tax on the sale of an investment, and that tax is postponed if he holds on to the investment, he may feel "locked in". As long as he holds, he would have, say, $100 working for him. If he sells, he would have only, say, $90 or $95 to reinvest. Since periodic revaluation would reduce this lock-in effect, it would reduce what might otherwise be an obstacle to the workings of the capital market. Revaluation would also make it feasible for the government to classify more corporate reorganizations and mergers as tax-free transactions than would otherwise be the case, thus removing a tax barrier that might otherwise have impeded transactions that are desirable for economic reasons. Finally, it would reduce the tax postponement which would otherwise result from the treatment suggested in paragraph *3.42* to those cases where the lack of marketability of the assets made the treatment compelling. 3.38 The process would not begin until five years after capital gains become taxable. Beginning in the first year, individual taxpayers would revalue their holdings of shares of widely-held Canadian corporations in each year in which they attain an age that is divisible by five. Corporations would also revalue their holdings of these shares every five years, likely on the fifth anniversary of incorporation and each other anniversary divisible	

by five. Dispersing the valuation process through a five-year cycle would reduce the pressure in any particular year—the pressure of the work load on the administration and the pressure that might otherwise develop on market prices every five years. To further disperse this latter pressure, it is proposed that revaluation take place as of the end of the month in which the significant birthday or anniversary takes place.

3.39 The general rule would be that capital gains and losses would be taken into account for tax purposes in the year in which the taxpayer disposes of the asset. Several exceptions are proposed to this rule. Some would result in tax not being due even though the taxpayer has sold the asset. These are explained later under the heading "rollovers". Two would result in a gain being taxed even though the taxpayer has not sold it. In the preceding section of this chapter a procedure was described whereby the gains accruing on shares of widely-held Canadian corporations would be taxed every five years, whether or not the owner sells the shares.

8.20 In the first year of the revised system, the inclusion of realized capital gains in income and the deduction of capital losses are estimated to produce net revenue of $60 million. This does not reflect an estimate of actual market behavior in 1969 but rather the longer-term relationship established in earlier years. It must be emphasized that this item cannot be forecast accurately, because it depends on changes in market values after the valuation date to be designated and on the behavior of Canadians confronted with a wholly new tax situation. If 1969 were the fifth year of the proposed system, the net tax revenue from realized gains and losses is estimated at $245 million. In addition, there is an amount of $100 million in respect of net gains arising through the periodic revaluation of the shares of widely-held Canadian

Present Tax Law	White Paper Proposals	Principal Points of Brief
	corporations. In the fifth year, approximately one-fifth of the taxpayers who hold shares would follow this process. It may be observed that Table 15, Item 11, page 95 of the White Paper estimates increased taxes five years hence of $100 M payable by individuals resulting from deemed realization of gains on widely-held company shares.	

Name of Company: The Investors Group

Principal Subject: Entertainment and Convention Expenses

Present Tax Law

Section 5-1-a of the Income Tax Act

This ensures that an officer or employee must include in income subject to tax, all amounts received as "Salary, wages, other remuneration, and gratuities, including the value of board, lodging and *other benefits of any kind whatsoever*" received or enjoyed by him in the year in respect of his office or employment.

Section 12-1-h of the Income Tax Act

This section provides that a taxpayer, primarily proprietors or partners, when computing income subject to tax *cannot deduct personal or living expenses.*

White Paper Proposals

1.35 Various fringe benefits received by employees or by the owners of businesses would be included in income for the first time. For example, an employee or owner of a business with a business-owned car available for his personal use would be required to include a minimum amount in his taxable income unless he pays the business at least that amount for the use of the car. There are other fringe benefits whose value cannot readily be measured in the hands of the recipient; for example, the use of hunting and fishing lodges, yachts and airplanes, the payment of social and recreational club dues, and the entertainment costs that are included in expense accounts. These costs would no longer be deductible to the employer.

8.18 A number of other smaller additions to revenue would arise from the inclusion of additional items in income and the reduction or elimination of some deductions. The total revenue forecast from the first group is $40 million and from the second group $60 million. The details of these changes and of the estimated revenue effects are set out in the footnotes to Table 15.

It may be observed that Table 15, Item 7, Footnote C page 95 of the White Paper estimates an increased annual tax of $5 M from further limiting the deduction of expenses incurred for the personal use of cars, etc.

Principal Points of Brief

See Page 20 of Brief

On this page the company expresses the opinion that

(a) convention expenses are productive and it is unreasonable to disallow them, and

(b) present provisions of the Income Tax Act are adequate to control claims for unreasonably large amounts of entertainment expenses.

Name of Company: The Investors Group

Principal Subject: Entertainment and Convention Expenses

Present Tax Law

Section 12-1-a of the Income Tax Act

This section provides that a corporation or business man when computing income subject to tax cannot deduct any outlay or expense that is not *incurred for the purpose of gaining or producing income from the business* carried on by the taxpayer.

Section 12-2 of the Income Tax ***Act***

This section provides the amounts claimed as a deduction in computing income which is subject to tax must *"be reasonable in the circumstances"*.

White Paper Proposals

2.11 The government has considered this issue at length. It proposes two sets of measures to remedy the disparity. First, in regard to those in business and the professions, and to certain types of benefits granted by employers to senior employees, it intends to set more rigorous limits to check "expense account living." The costs of attending conventions and belonging to clubs would no longer be permitted as a charge in determining business income. The costs of yachts, hunting and fishing lodges or camps, amounts spent for tickets for games and performances, and costs of entertainment would also be excluded. Owners or employees of a business having a car on aircraft available to them for their personal use, including travel to and from home, would have to pay the business a minimum stand-by charge, or have a corresponding amount added to their personal income for tax purposes.

5.9 Although the government believes that provision should be made for the deduction of legitimate business expenses that have not previously been deductible, it also believes that the present system permits deduction of certain types of expenses which taxpayers should be expected to meet out of tax-paid income. Consequently it is proposed that the Income Tax Act specifically deny deduction for entertainment expenses, the costs of attending or sending employees to conventions, and the cost of dues for membership in social or recreational clubs. This provision would not prohibit the expenditure of funds for these purposes, but it would ensure that taxpayers who wish to make such expenditures would do so out of after-tax dollars.

Principal Points of Brief

White Paper Proposals

5.10 Under the system outlined in Chapter 4, whereby shareholders are given credit for the tax paid by their corporations, merely denying a deduction for this type of expenditure is not sufficient. Although the denial of the deduction would mean that the corporation pays extra tax, the shareholders of the corporation would receive credit for the extra tax paid. Therefore, it is necessary to provide further that, in the case of corporate taxpayers, taxes due because of the non-deductibility of these expenditures would not be creditable.

8.29 On the other hand the termination of depletion allowances on royalty income is estimated to increase revenue by $10 million in each year. The disallowance of deductions for the cost of club dues, conventions, entertainment, etc. is expected to save $5 million in revenue in both years. Finally, the new provisions to prevent diversion of income to tax-haven countries is expected to save about $10 million in both years.

It may be observed that Table 16, Item 7, page 96 of the White Paper estimates an increased annual tax of $5 M payable by corporations as a result of the cancellation of deduction of club dues, entertainment expenses, conventions, etc.

APPENDIX "C"

Submission To:

Standing Senate Committee
on Banking, Trade & Commerce,

The Senate,
OTTAWA, Ont.

RE: PROPOSALS FOR TAX REFORM
PRESENTED BY
CANADIAN REALTIES FUND OF MONTREAL

Canadian Realties Fund is a common law trust formed in Canada for the purpose of providing a vehicle to European investors by means of which they can invest directly in Canadian real property. The Trust was formed in 1955 under a Trust Agreement entered into with a management company in Canada called Secfin Company Ltd. Participation certificates have been issued to and subscribed for by non-resident investors. These certificates appear to be of the same character as those referred to in paragraph 5.56 of the White Paper as being transferable and redeemable units, each of which represents a specific undivided interest in the trust property. While the units are in bearer form, it can be established that the certificates were all issued to foreign, essentially Swiss, banks that purchased them for their clients.

The assets of the Trust comprise rental properties in Canada. At the present time, and since its inception, under the Income Tax Act Section 63 subsection (4), Canadian Realties Fund deducts from its annual income such part as is payable to beneficiaries of the Trust within the year. Since its entire income is paid out each year to the certificate holders, the Trust itself bears no tax under the existing Income Tax system. In addition, Section 106(1)(c) of the Income Tax Act levies a flat rate of tax at 15 per cent on the income which the certificate holders derive from Canadian Realties Fund in its quality as a Canadian resident trust.

Under the White Paper, the proposed treatment of this type of trust will be much more adverse to the certificate holders than the present law. In fact, it is safe to say that if the White Paper provisions are implemented in this respect, Canadian Realties Fund will have no option but to immediately liquidate and distribute its assets and cease operations in Canada. This is said advisedly, and after much reflection on the White Paper and its proposals. It is hoped that the White Paper may be altered to eliminate the adverse incidence of its provisions upon Canadian Realties Fund and it is with this hope in view that the following explanation of how we believe the White Paper will affect the Fund is put forward for the benefit of this Committee.

1. It appears that Canadian Realties Fund will be taxed as a widely-held corporation and accordingly any income which it receives after the same charges which it enjoys today, i.e., management costs, capital cost allowance and interest, will be taxed at 50 per cent. This 50 per cent rate of tax will be borne by the Trust on income which today is not taxed because it is distributed to the unit holders as above described.

2. Further, the income of the Trust will include any capital gains from the disposition of real property.

3. Until 1973, the 15 per cent withholding tax will still be required to be withheld on payments made to non-residents and after 1973 the withholding tax will go to 25 per cent unless the non-resident can demonstrate that he resides in a country which has a Tax Convention with Canada. Since the certificates are bearer in form, this will be impossible to do and one can only assume that the withholding tax rate will remain at 25 per cent.

Canadian Realties Fund was formed to provide an attractive yield of slightly over 6% together with some reasonable protection against inflation. This has been achieved by providing for the payment annually to the unit holders of the income of the Trust as it would be computed under the Income Tax Act after deducting capital cost allowance, but without taking any account of capital gains or losses, save in certain isolated instances.

It will be seen therefore that the extractable income available to the non-resident certificate holder in every dollar of net income earned by Canadian Realties Fund is almost double under the present system what it would be under the White Paper proposals.

What is particularly perplexing when regarding the White Paper's application to Canadian Realties Fund is that under the White

Paper proposals if a non-resident were to own a real property in Canada directly, which he could lease on a net net basis, he would suffer income tax only at a 15% rate if he were a resident of a Treaty country or a 25% rate after 1973 if not. He would, of course, pay tax on capital gains realized by him but his income tax rate would be 15% or 25% as against the 62½% that he would suffer were he to retain his interest in Canadian Realities Fund.

It is for the foregoing reasons that the management of Canadian Realties Fund has concluded that, if the White Paper proposals are not modified at least so as to place it in the same position as that of a direct investor in Canadian real estate, the Fund will have to be wound up as soon as possible.

Schedules will be introduced in due course to illustrate the above propositions.

The whole respectfully submitted by:

STIKEMAN, ELLIOTT, TAMAKI,
MERCIER & ROBB and
RIDDELL STEAD & CO.
for
CANADIAN REALTIES FUND

Montreal, P.Q.
February 23, 1970.

CANADIAN REALTIES FUND
STATEMENT OF ASSETS AND LIABIILTIES

DECEMBER 31, 1969

Investment in properties—at cost .		$16,590,281
Less Accumulated depreciation .		2,326,523
		14,263,758
Mortgages receivable		707,596
Current assets		447,864
TOTAL ASSETS		15,419,218
Less:		
Mortgages payable	$ 3,285,964	
Current liabilities	876,280	4,162,244
Certificate Holders Equity		$11,256,974
	Par Value	Book Value
Represented by:		
40,000 Special Certificates	$ 40,000	$ 40,000
228,580 Certificates	11,442,240	11,206,974
$10,000 Trust Donation	10,000	10,000
	$11,492,240	$11,256,974

CANADIAN REALTIES FUND

EFFECT OF WHITE PAPER PROPOSALS ON CERTIFICATE HOLDERS

(Based on 1969 Financial Statements)

Statement of Revenue—net income		$ 677,450
Statement of Special Surplus		
Revenue for year	$ 44,326	
Less: Expenses	37,408	6,918
		684,368
Depreciation per Statement of Income from Properties	90,790	
Less: Capital Cost Allowance claimed	20,082	70,708
Income of the Fund		755,076
Distributed to Certificate Holders and subject to withholding tax		
Special Certificates	4,000	
Ordinary Certificates	751,076	755,076
Taxable income of the Fund		$ Nil

The results of the Fund's operations have been dealt with as follows:

(a) The income of the Fund as shown above was distributed to the Certificate Holders after deduction of 15% withholding tax.

(b) The capital loss of $172,860 (statement of capital loss) was deducted from the Certificate Holders' Account. If this loss has been deducted from income the amount distributed to Certificate Holders would be $582,216. This would result in a balance of income of $172,860 remaining in the hands of the trust which under the present taxing legislation is subject to tax at personal rates. The tax so payable would amount to $105,000.

Tax Payable by Trust	White Paper	Present
Income of Fund	$ 755,076	$ 755,076
Tax at 50%	377,538*	Nil
	377,538	755,076
Tax Payable on distribution		
Withholding tax—25%	94,385	
—15%		113,262
Received on distribution by Certificate Holders	$ 283,153	$ 641,814
Return on Certificate Holders' investment as at December 31, 1968 ($12,022,899)	2.3%	5.3%
1969 ($11,256,974)	2.5%	5.7%
Capital loss	$ 172,860	$ 172,860
Tax effect 50%	(86,430)*	—
Capital loss deducted from Certificate Holders' investment	$ 86,430	$ 172,860

Assumptions:

(1) The Fund will be considered a widely held corporation under the White Paper.

(2) Income and capital losses will be treated as noted above.

(3) CCA is less than depreciation charged in the accounts.

(4) Deductions for capital losses in the Canadian Properties Trust will flow through to Certificate Holders of Canadian Realties Fund under the White Paper.

Note: Properties valued in excess of $50,000 must be treated as a separate tax class under the White Paper. This will not affect the income comparisons for the year 1969, however future years may be affected.

APPENDIX "D"

Name of company: Canadian Realties Fund of Montreal

Principal Subject: Taxation of Trusts with Non-resident Unit Holders

ANALYSIS OF APPENDIX "C" BY SENIOR ADVISOR

The authors of the White Paper have proposed sweeping changes in the taxation of income of trusts, without regard to the facts that trusts may have been set up in past years to comply with present rules of taxation of trust income.

In brief the proposals are:

(1) Where the trust deed requires that the income of a trust be accumulated by the trustee, that is, be capitalized instead of being distributed annually, the trustee must pay a tax of 50 per cent of the income capitalized (40 per cent federal, 10 per cent provincial).

This proposal compares to the present law that requires the trustee to pay tax at the graduated rates of tax payable by individuals (without deduction for personal exemptions) on any trust income that is capitalized.

This proposal is referred to as the closing of a loophole in the present system.

(2) Where a trust has issued redeemable or transferable units, it is proposed that it be treated as a Canadian corporation and be required to pay an annual tax of 50 per cent (40 percent federal, 10 per cent provincial) so that Canadian unit holders may be granted a dividend tax credit of varying amounts, according to the number of unit holders and the marketability of the units.

Non-resident unit holders will not be entitled to the dividend tax credit, but will be subjected to a Canadian tax of 15 per cent or 25 per cent of the trust income credited or distributed to them.

This proposal compares to the present tax law that taxes Canadian unit holders on trust income at the graduated rates applicable to individuals and taxes non-resident unit holders at a flat 15 per cent of trust income.

The foregoing proposals appear to be a part of the theory proposed by the authors of the White Paper that all income of a Canadian trust or corporation must bear a tax of 50% to entitle Canadian shareholders or unit holders to receive a dividend tax credit of varying amounts. This proposal has been referred to in Special Study No. 4 dealing with the "Grossing-up" of Canadian dividends.

The above proposals that are set out in Paragraphs 5.55, 5.56, 5.57 and 5.58 of the White Paper, if adopted, will increase very considerably the taxes payable on trust income and will drive out of Canada those non-resident beneficiaries who are free to take such action.

The following brief deals solely with the position of Non-Resident Unit Holders of a Canadian real estate trust, if the White Paper proposals are adopted.

There follows the usual summary showing the Present Tax Law, White Paper Proposals and Principal Points of the Brief.

Name of company: Canadian Realties Fund of Montreal

Principal Subject: Taxation of Trusts with Non-Resident Unit Holders

Present Tax Law	*White Paper Proposals*	*Principal Points of Brief*
Section 63 of the Income Tax Act At the present time, the trustees of a trust must account to the Taxation Division for all annual income received by the trust.	The authors of the White Paper propose that all trusts be treated as corporations and be required to pay Canadian corporation taxes of 50% on the annual income of the trust if they have issued transferable or redeemable units.	This Brief points out the impact of the White Paper proposals on the non-resident unit holders of a Canadian real estate trust that has issued bearer units.
To the extent that annual income of the trust is distributed in the year to a beneficiary, such distribution is subject to tax in the hands of the beneficiary and is deductible from the total income received by the trustee.	The trust will then be treated as a closely-held or widely-held corporation for purposes of computing the dividend tax credit allowed Canadian beneficiaries of the trust, according to the number of unit holders of the trust and marketability of the units.	Note that Page 3 of the Brief concludes that the Canadian Realties Fund of Montreal will be wound up immediately if the White Paper proposals are adopted.
Any balance of annual income received by the trustee is taxable in the hands of the trustee at the rates of tax applicable to individuals. The balance of such income, after deducting the tax theron, may be distributed to beneficiaries free of further tax.		
Section 106-1-c of the Income Tax Act	The proposal reads:	
This section provides that a Canadian tax of 15% must be paid on any distributions of income made by a trustee of a trust to non-resident beneficiaries.	5.56 Because a trust is not taxed on income which is payable to its beneficiaries during the year, many trusts do not pay any tax at all. Some of these trusts are in direct competition with widely-held public corporations and have as many beneficiaries (in this case usually unit holders) as some public corporations have shareholders. The tax rules give	

Present Tax Law

In summary, under present tax law:

(a) the trust itself is not subject to a separate tax, as is a corporation;

(b) distributions of income of the trust made to beneficiaries are

(i) subject to the usual Canadian income taxes when the beneficiaries are Canadians, and

(ii) subject to a 15% Canadian tax when the beneficiary is a non-resident of Canada.

(c) The portion of the income of th trust that is accumulated by the trustee is taxed in the trustee's hands of the graduated rates of tax payable by Canadian individuals, and the balance remaining can be distributed free of tax to the beneficiaries.

White Paper Proposals

these trusts an advantage over their competitors. It is proposed that a trust be treated as a corporation if it has issued transferrable or redeemable units, each of which represents a specific undivided interest in the trust property. If the number of unit holders and marketability of the units warrant it, the trust would be treated as a widely-held corporation. If such a trust were a mutual fund, it would be taxed in the same manner as an incorporated mutual fund.

The White Paper makes no direct reference to the taxation of non-resident unit holders of a trust that has issued transferable or redeemable units.

However, the White Paper does propose that Canadian withholding taxes in future be:

(i) 15% if the unit holder is a resident of a country with whom Canada has a tax treaty, (there are presently 15 such countries) and

(ii) 25% if the unit holder is a resident of any other country.

Accordingly these rates of tax will apply to non-resident holders of unit who receive distributions of income from a trust that is taxed as a Canadian corporation.

Under the heading of loop-hole closing, the White Paper proposes to impose a 50% tax on the income of trusts where income of a trust is not distributed annually to beneficiaries. This proposal reads:

5.57 The fact that a trust is entitled to use the personal rate schedule in computing its tax means that income accumulated in a trust may bear significantly less tax than if the income were taxable to the beneficiaries, and the tax saving is not offset by a further tax when the funds are eventually distributed. (The number of accumulating trusts has

Principal Points of Brief

increased significantly during the past few years.) If a trust is covered by the proposal set out in the preceding paragraph, this loophole would no longer be available. To close it for other trusts, it is proposed that income accumulating in such trusts be subject to a flat-rate federal tax of 40 per cent; provincial taxes would increase this rate to the neighbourhood of 50 per cent and the corporate rate, A special relieving provision would reduce the rate in the case of trusts or estates arising on the death of someone whose economic circumstances were such that a 50-per-cent rate is not appropriate, provided no additional property is transferred to the trust by anyone else.

5.58 Less is known of the use to which trusts are put in Canada than is the case with respect to corporations, and given the varied uses that are possible, it is difficult to foretell all of the effects of the proposal discussed in the preceding paragraph. Consequently the government issues a particular invitation to taxpayers who believe that they would be unfairly treated under it to make the facts of their case known to the Department of Finance so that modifications can be considered.

APPENDIX "E"

SPECIAL STUDY NO. 4

GROSSING-UP OF CANADIAN DIVIDENDS

INTRODUCTION

One of the major proposals of the authors of the White Paper is set out in the following paragraphs thereof:

1.39 The government proposes to alter the method of taxing corporations by establishing a single rate of corporation tax and providing a system of credits to shareholders for corporate taxes paid. An important distinction would be made between private, closely-held corporations and public, widely-held corporations.

1.40 For closely-held corporations, which are usually smaller businesses managed by the shareholders, the tax should be related as closely as possible to rates paid by individual shareholders. There is usually a close identity between the shareholders and the corporation. These corporations usually compete in markets with unincorporated businesses subject only to personal income tax. Under the proposed plan the federal income tax paid by such corporations would be treated as a prepayment of the personal income tax on behalf of individual resident shareholders. Under certain conditions the corporation could elect to be taxed as a partnership of its shareholders. In other cases the shareholders would pay tax on a sum that includes their dividends plus a related amount of corporate tax already paid; and they would then claim credit for the corporate tax paid, and qualify for a refund if their own rates are lower than the corporate rate.

1.42 Widely-held corporations are usually larger businesses where the link between shareholders and management is tenuous. Such corporations are themselves important economic entities. Their products or services are usually sold in competition with other large corporations, where prices yield an adequate return after paying corporate tax. One half the corporate income tax paid by such corporations would be regarded as a prepayment of individual tax for individual Canadian resident shareholders, but the other half would not be linked in this way. Shareholders receiving dividends from profits taxed under the new plan would be liable for tax on the dividend plus an amount of "creditable tax" equal to half the dividend and would be given credit for that amount of tax. This system would be roughly equivalent to the present dividend tax credit for taxpayers in the 50-per-cent tax bracket and would be more favorable for those in lower tax brackets. It would thus provide a powerful incentive for investment by Canadians in Canadian corporations.

To implement the proposal outlined in Paragraph 1.39 above, the authors of the White Paper deem it necessary to eliminate the lower rate of taxes allowed on the first $35,000 of taxable income, to confiscate by way of income tax any subsidies paid to encourage scientific research and the like, remove tax incentives allowed to the extractive industries and new industries in designated areas, and levy Canadian taxes on the earnings of foreign subsidiaries of Canadian companies.

The justification of this seemingly ruthless sweeping away of existing benefits to encourage industry is to grant tax credits to Canadian shareholders who may receive dividends from Canadian companies within a period of two and one-half years after the year in which the income is earned by the corporation.

The tax-credit to be permitted Canadian shareholders will be computed in accordance with the following formula:

	Closely-held Corporations		Widely-held Corporations	
	Federal	Provincial	Federal	Provincial
Canadian dividend received	100		100	
Amount to be added to dividend received to achieve "grossing-up"	100		50	
Amount of dividend to be included with other income of individual shareholders	200		150	
Tax on total income at increased rates proposed in White Paper	xx	28% of federal tax	xx	28% of federal tax
Less deduction from tax payable on total income	80% of dividend received of 100	20% of dividend received of 100	40% of dividend received of 100	10% of dividend received of 100
Net tax payable	xx	xx	xx	xx

The system of grossing-up dividends proposed for Canada by the authors of the White Paper was first introduced in Great Britain in the mid-1800's at a time when the principles of taxation were being develop on a trial and error basis.

This system has in more recent years been progressively abandoned by Great Britain as failing to meet day demands of governments.

The grossing-up system was finally abandoned by Great Britain in 1965. An extract from the Budget Statement of the Chancellor of the Exchequer of April 6, 1965, may be of interest to members of the Standing Committee. It follows, with underlining inserted by your advisor:

> "Our present method of taxing corporate bodies goes back to the days before the joint stock company, as we know it, existed, when the few companies that did exist were thought of as being in the nature of large partnerships. At that stage, income tax was virtually a flat-rate tax: it applied to the income of companies and individuals alike; and when a company distributed its income to its shareholders in the form of a dividend, a second lot of tax was not exacted. Since those days, there have been extensive changes both in the tax system and in the status and position of companies.
>
> First, the personal income tax has become a graduated tax, differentiated according to the circumstances of each taxpayer, and made progressive by reduced rate relief at the lower end of the scale, and surtax at the upper end. Secondly, company taxation has been altered by the introduction of profits tax, which is imposed on the whole profits of a company, whether or not distributed, and is not repayable to shareholders. *These changes have made obsolete the idea that companies and individuals should be treated for tax in the same way. By separating formally the two taxes, namely, the tax on corporations and the tax in individuals, we shall be bringing the tax system of the United Kingdom into line with reality and adopting what has become the general practice throughout the world.*
>
> Hitherto, any idea of reforming the tax system by introducing a corporation tax in this country has foundered because of the widely held view that to levy a separate tax on company profits which is distinct from and additional to, the income tax levied on individuals would constitute 'double taxation' of company profits. The profits tax already contradicts this argument. *The truth is that only part of a corporation's income is distributed to the shareholders in the form of dividends; the rest is not part of personal income and cannot be treated*

as such. The majority of the Royal Commission on Taxation came near to this view when it said:

> *'We accept the necessity for the subjecting company profits to a special tax regime that is something more than a mere attempt to collect personal income tax in advance.'*

But it baulked at the logical conclusion, which is that there should be a separate tax on the profits of corporations quite distinct from the income tax that is levied on distributed profits.

There then remains the questions of how to frame the tax on company profits. *As soon as it is divorced from the taxation of individuals, we are free to draw it up on principles most conducive to economic growth and efficiency.* The two ways open to us of raising the same amount of revenue from corporations are, either to confine the tax to undistributed profits and levy it at a relatively high rate; or, alternatively, to impose a tax on the whole profits, irrespective of distributions, at a much lower rate.

The latter tax, in my view, has a much greater economic and incentive value than the former. A tax confined to undistributed profits penalises investment and growth; it severely handicaps the young and dynamic companies which may rely on ploughed-back profits for expansion. A tax on the whole profit has the opposite effect. It makes it possible to shift the burden of taxation in such a way as to relieve the faster-growing companies, which are generally low distributors, and thus enable them to expand even faster. It will place more of the burden on those companies which are high distributors. *It gives a strong incentive to all companies to plough back more of their profits for expansion.* Finally, the incentives to cut costs and to raise efficiency through new investment are much stronger, and must be much stronger when a lower percentage of additional profits is taken in taxation than under the present system where 56¼ per cent of any additional profit would go to tax.

The present system is also unnecessarily complicated because of the existence of two taxes—income tax and profits tax—levied broadly on the same income but according to different rules. It is a patchwork system and it is not standing up to the strains that result from the efforts of Governments to use the tax system for economic purposes. *The result has been the growth of abuses and anomalies, such as recovery by companies or individuals of large sums from the Revenue by way of repayment of tax, although no corresponding sum has ever reached the Exchequer".*

(Simn's Income Tax—Vol 2A—Page 404)

It may be that the portions in italic of the above statement have a meaning equally applicable to Canada.

Members of the Committee will be hearing briefs on the proposal to gross-up Canadian dividends. They will have to consider whether Canada, if it abandons its long-established system of taxing corporations in favour of a system recently abandoned by the country that introduced it, may be exposing Canadian business to those risks referred to by the Chancellor of the Exchequer of Great Britain on April 6, 1965.

Queen's Printer for Canada, Ottawa, 1970

Second Session—Twenty-eighth Parliament
1969-70

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE
ON
BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 11

WEDNESDAY, MARCH 11th, 1970

Sixth Proceedings on the Government White Paper,
entitled:
"PROPOSALS FOR TAX REFORM"

WITNESSES:

(For list of witnesses see Minutes of Proceedings—Page 11 : 5)

APPENDICES:

"A"—Brief from Nova Scotia Light and Power Company, Limited.
"B"—Brief from Canadian Gas Association.
"C"—Brief from Consumer's Gas Company.
"D"—Brief from Canadian Utilities, Limited; Canadian Western Natural Gas Company Limited; Northland Utilities Limited and North-western Utilities Limited.
"E"—Brief from Newfoundland Light & Power Co. Limited.
"F"—Brief from Maritime Electric Company, Limited.
"G"—Analysis of Appendices "A", "B", "C", "D", "E" and "F" by Senior Advisor.
"H"—Special Study No. 4—(*Revised and Supplemented*).
"I"—Special Study No. 5—Taxation of small businesses.

21636—1

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aseltine	Desruisseaux	Kinley
Beaubien	Everett	Lang
Benidickson	Gélinas	Leonard
Blois	Giguère	Macnaughton
Burchill	Grosart	Molson
Carter	Haig	Phillips (*Rigaud*)
Choquette	Hayden	Walker
Connolly (*Ottawa West*)	Hays	Welch
Cook	Hollett	White
Croll	Isnor	Willis—(30)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

"With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intituled: "Proposals for Tax Reform", prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

"With leave of the Senate,

The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Hayden:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

21636—1½

MINUTES OF PROCEEDINGS

WEDNESDAY, March 11th, 1970.
(15)

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to further consider:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Hayden (*Chairman*), Aseltine, Beaubien, Blois, Burchill, Connolly (*Ottawa West*), Flynn, Gelinas, Haig, Hays, Hollett, Isnor, Kinley, Lang and Welch—(15).

Present, but not of the Committee: The Honourable Senators Laird and Sullivan—(2).

In attendance: Arthur W. Gilmour, Senior Advisor; Alan J. Irving, Legal Advisor and Roland B. Breton, Executive-Secretary.

The following witnesses were heard:

Nova Scotia Light & Power Company, Limited:

A. R. Harrington, President and General Manager;

H. B. Rhude, Counsel.

Canadian Gas Association:

Edmund C. Bovey, President of Canadian Gas Association and Northern & Central Gas Association;

F. Warren Hurst, Vice President—Finance, Consumers Gas Company Limited;

John Maybin, Chairman and Chief Executive Officer, Canadian Utilities Limited;

Neil F. Phillips, Q.C., Counsel.

Consumers' Gas Company:

F. Warren Hurst, Vice President, Finance.

Canadian Utilities, Limited;
Canadian Western Natural Gas Company Limited;
Northland Utilities Limited and
Northwestern Utilities Limited:

John Maybin, Chairman and Executive Officer;

A. G. Burton, C.A.

Newfoundland Light & Power Co. Limited:

D. C. Hunt, Director and Counsel;

D. S. Templeton, General Manager;

C. F. Mallory, Executive Vice-President.

Maritime Electric Company, Limited:

A. H. Peake, Director and Counsel;

A. D. Cameron, Vice President.

Mr. Gilmour presented to the Committee a *revised* and *supplemented* Special Study No. 4, together with Special Study No. 5 upon which a short discussion followed.

Ordered:—That the documents submitted at the meeting today be printed as appendices to these proceedings, as follows:

"A"—Brief from Nova Scotia Light and Power Company, Limited.

"B"—Brief from Canadian Gas Association.

"C"—Brief from Consumers' Gas Company.

"D"—Brief from Canadian Utilities Limited; Canadian Western Natural Gas Company Limited; Northland Utilities Limited and North-western Utilities Limited.

"E"—Brief from Newfoundland Light & Power Co. Limited.

"F"—Brief from Maritime Electric Company, Limited.

"G"—Analysis of Appendices "A", "B", "C", "D", "E" and "F" by Senior Advisor.

"H"—Special Study No. 4—(*Revised and Supplemented*).

"I"—Special Study No. 5—Taxation of small businesses.

At 12:20 p.m. the Committee adjourned to the call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Ottawa, Wednesday, March 11, 1970.

The Standing Senate Committee on Banking, Trade and Commerce, met this day at 9.00 a.m. to give further consideration to the White Paper entitled, "Proposals for Tax Reform".

Senator Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: We proceed now to the main purpose of the meeting. This morning we have six groups appearing to make submissions in connection with the White Paper. The six groups are, in the order I propose having them appear unless the committee wishes to change it: The Nova Scotia Light & Power Company Limited, the Canadian Gas Association, the Consumers' Gas Company, a group of four comprised of Canadian Utilities Limited, Canadian Western Natural Gas Company Limited, Northland Utilities Limited and Northwestern Utilities Limited. I assume that the four will be heard as a group. Then we have the Newfoundland Light & Power Company Limited and the Maritime Electric Company.

The same point is raised in all these submissions, the basis for which is to be found in paragraphs 4.63, 4.64 and 4.65 of the White Paper. If I might take a moment, I can tell you that those paragraphs deal with a statute, which I am sure many of the senators here remember, which was passed in 1966, entitled the Public Utilities Income Tax Transfer Act. Under that statute provision was made to transfer to the provinces 95 per cent of the income tax paid by public utilities in relation to the utilities business. There was also provision in that act under which if the province saw fit to transfer any part of the tax proceeds to a utility company or companies in the province that amount would be regarded as exempt income. The White Paper proposes to increase that 95 per cent to 100 per cent. It also proposes that there will be no tax credit to shareholders who receive dividends from the public utilities concerned. This is the burden of the submissions we are going to hear today, that in fact these companies do pay federal corporate tax, because you cannot just reach in and take money from a company. There must be some authority to tax and the authority is in the Income Tax Act. This is a distribution of the money after it has been received by the federal collector. It is the question of distribution and the problem which we have is as to whether the position of these people is sound. That is, that they are entitled to the principle of tax credit which is asserted as part of the White Paper. If that is to carry through, then they submit they are qualified the same as any other company that pays federal tax and should not be singled out and refused that right, otherwise you will be exposing these shareholders to whatever their individual rate of tax is without any credit of any kind.

Senator Isnor: Let me get this correct, Mr. Chairman. This 95 per cent that you have mentioned goes to the company or the province.

The Chairman: That goes into the general revenue of the province. Alberta is the only province in Canada that pays over the money which it receives to the utilities.

Senator Isnor: If that province has a utility—we say a competitor to the private company, they make use of that 95 per cent in any way they see fit?

The Chairman: No. What the province does with the money that it receives is the business of the province. They can eat it if they can find some way of doing that or burn it up—anything they wish to do with it, because it is their money.

Senator Isnor: If the province was carrying on business, which some of them are doing, with the utilities, in competition to the private company, then they would have use of this 95 per cent tax rebate?

The Chairman: What you are suggesting is that they might apply it to assist the publicly owned development.

Senator Isnor: To their own organization, yes.

The Chairman: Well, I suppose it is an interesting theory.

Senator Flynn: Is the proposal in the White Paper to refuse the tax deduction even when there is no return by the province to the company?

The Chairman: To refuse it in all circumstances.

Senator Flynn: In all circumstances?

The Chairman: Yes.

Senator Flynn: The taxes paid by the federal are transferred to the province and they say because of that you would be disallowed and the shareholders would not get it.

The Chairman: The shareholders in respect of the dividends which he receives will not qualify for a tax credit.

Senator Flynn: Is there any reason in the White Paper for that?

The Chairman: If you read paragraphs 4.63, 4.64 and 4.65, you will not find any reason.

Senator Flynn: All right.

The Chairman: I thought you were using "reason" in a different sense.

Senator Beaubien: Is it true to say that the federal Government refunds part of all the corporation tax to the provinces?

The Chairman: Certainly.

Senator Beaubien: So that this is only a question of degrees?

The Chairman: That is right. I should tell you the history of this. For those who are interested, if you go back and look at the *House of Commons Hansard* in 1966 when Mr. Sharp was the Minister of Finance and when this bill was introduced—the Public Utility Income Tax Transfer Act—he gave an explanation and history in relation to the taxation of public utilities. He explained that originally the refund or the transfer payment out of taxes on utilities were in the order of 50 per cent of the corporate taxes on such utilities, and it was provided in the tax rental agreements and carried through for five years at a time. It then reached a period in the early 60s—you can find this in his speech—where this provision was dropped from the tax rental agreements and the government gave an undertaking it would be dealt with separately. It was then put into the Estimates each year for a number of years. Then in 1966 when the percentage was moved up to 95 per cent the present Act was passed. Therefore, you can see that this was created as part of the distribution of funds from the federal authority to the provinces and that is why you found it in the tax rental agreements. As to the question, has there been any change in the basic principle, it still would appear to be distribution of federal moneys to the provinces.

Senator Flynn: The main reason, if I remember, for this legislation, was that in most provinces these utility companies are publicly owned and there was no tax. Is that not correct?

The Chairman: No. The companies who are appearing before us today...

Senator Flynn: For instance, the Quebec Hydro was not applying any federal tax, but the water and power at that time was and it sort of created an imbalance.

The Chairman: It was intended to enable the provinces to put the privately operated public utilities in a reasonably competitive position with the provincially owned public utilities. I think the intention of paying the money was so that it might be applied to establish or re-establish a competitive position. One province that has done something in the way of contribution of this money to the utilities customers is Alberta. The others just apply it to their general revenues.

Senator Hays: In the meaning of the act, the intent was that it would be refunded to the consumer.

The Chairman: You may say the intent, but if you read the act and Mr. Sharp's statements at the time he was asked that specific question, you will see why he did not put into the bill a requirement that the money be rebated by the province to the utilities. He said no, that this is a non-conditional transfer of funds from the federal authority to the province.

Senator Hays: I say this because I discussed it with Mr. Gordon when he was Minister of

Finance. At that time Calgary Power was a privately owned company. I suppose in putting the act in, that it was better to do it this way. Originally, that was the intent.

The Chairman: The form in which it takes in the statute is a non-conditional payment.

One thing which I should tell you is that on the last day on which we met we postponed a statement which Mr. Gilmour was going to make. This statement has to do with small businesses and we will deal with it as soon as we complete the submissions today. We will hold that in reserve for you. If you want to hear about small businesses it will be necessary for you to stay through the meeting.

The first delegation we are going to hear this morning represents the Nova Scotia Light & Power Company Limited. Mr. MacKeen is Chairman of the Board, Mr. Harrington, President & General Manager, Mr. Kennedy, Executive Finance Officer and Mr. Rhude, Counsel. Would you all come forward, please?

Mr. A. R. Harrington, President & General Manager, Nova Scotia Light & Power Company Limited: Mr. Chairman and honourable senators, on behalf of the Nova Scotia Light & Power Company Limited I think it would be useful to introduce the group representing the company today. On my extreme right is Mr. C. N. Kennedy, Vice President of Finance; Mr. J. C. MacKeen, Chairman of the Board of Directors, and Mr. Harry Rhude, Counsel for the company and member of the firm of Stewart, MacKeen & Covett of Halifax.

Mr. Chairman, I have an opening statement which might be useful in summarizing and somewhat complementing the brief of the company.

Mr. Chairman and honourable senators, Nova Scotia Light and Power Company, Limited has filed a brief with your committee with respect to paragraphs 4.63, 4.64 and 4.65 contained in the Proposals for Tax Reform. In this brief the company made four particular points.

It appears that those drafting the proposals for tax reform have mixed the principles of tax collection with the principles of tax distribution to the extent that although electric and gas utilities are paying and will continue to pay full income taxes to the same extent as other widely held companies, they are being treated as if, in fact, they paid no taxes at all because of the way in which Canada distributes revenues gathered from these utilities.

By proposing to treat electric and gas public utilities differently than other widely held companies, the White Paper has adversely affected the competitive position of these companies in seeking their capital requirements for expansion from normal market sources. The electric and gas public utilities are required to expand even in periods of inflation in order to support the economy of Canada. The proposals in the White Paper have such an impact on their access to capital markets that it is a matter of considerable question whether they, in fact, will be able to find sufficient capital to expand to meet their responsibilities.

It appears in the proposals for tax reform that those preparing this document have not been fully aware of the method of distribution of public utility income taxes under the Public Utilities Income Tax Transfer Act. The Honourable Walter L. Gordon, Minister of Finance, in July, 1965, announced that the federal Government had agreed to transfer to the provinces almost 100 per cent of its collection of corporation income tax from certain public utility companies. I quote from the official press release: "The Minister explained that 5 per cent of the collections would be retained by the federal Government to cover the cost to it of giving individuals who are shareholders of the companies concerned the deduction from tax allowed to all Canadian individuals in respect to their dividend income."

It would appear to us that in the drafting of the proposals for tax reform, this 5 per cent retention by the Government of Canada was considered to be the only source of funds available to Canada to cover dividend tax credits. We have shown in our company's brief, however, that since the Government of Canada does in fact retain the monies collected for a period of three years without payment of interest, the amount retained to cover dividend tax credits is considerably more than 5 per cent. On the basis of present interest rates, Canada is actually retaining more than enough to cover the dividend tax credit under the present formula and, in fact, would lose money if it changed to the system proposed in the White Paper.

Mr. Chairman and honourable senators, I must confess that, even on examining this breakdown of the transfer under the Income Tax Transfer Act, we, in our Schedule C made a mistake. Forgive me if I suggest that the method of the transfer is somewhat complicated. We have attempted to find actual

figures from the provincial government of Nova Scotia, but because they are mixed in with other transfers it is most difficult to relate the amount for any particular year to the amount for report, say, in the company's annual statement.

The mistake was pointed out by Mr. Gilmour in the Committee report of February 11 where actually we show in Schedule C in our brief that 28 per cent of the total tax normally goes to the provincial government with respect to the individual taxpayer—where actually it is 28 per cent of the federal tax, which means that it is really only 22 per cent of the total. This does affect our figures as in Schedule C. I will mention them shortly, and Mr. Rhude, who is with me, is prepared to go into this in detail.

The calculation shown in Schedule "C" of the company's brief assumes that all earnings are paid out in dividends. Thus the calculation is one where Canada makes maximum allowance for dividend tax credits. In fact, the company has only paid out an average of 70 per cent of earnings on dividends during the past ten years. This has been a continuing policy of the company, to be in that range. On this basis, the amounts available to Canada after dividend tax credit are considerably more than shown on the schedule. As a matter of fact, in our Schedule C, we show on the basis of 100 per cent distribution of earnings, that Canada retained $1.07 more than necessary per $100 of earning, for a 30 per cent marginal taxpayer. Due to the error I have mentioned, this figure, instead of being $1.07 retained per $100, is 93 cents short per $100, or .93.

In the case of the 50 per cent marginal taxpayer, where we have shown that Canada retained $7.90, the adjustment makes the net figure $6.48.

Where our average shareholder is judged to be in the 40 per cent bracket, or midway between the two, it does not affect the principle which the company maintains, that there is more than enough in the method of transfer for Canada to retain more than enough in the dividend tax credit.

If you examine the factual tax situation, where we only pay out 70 per cent of the dividend, then for the 30 per cent taxpayer Canada would retain approximately $8.50; and for the 50 per cent taxpayer they retain $11.83 per $100 of earnings.

These are corrected figures on the basis of the question.

These matters of calculation of the transfers are such that forgive us if we assume that those drafting the White Paper may have been led into some of these traps also.

The fourth point made by the company is as follows:

Since the proposals for tax reform have been introduced only as proposals subject to change, and are not to be considered as legislation, the Government could not have desired or intended that the impact of these proposals would during the examination period cause serious difficulty for the utility companies. The shares of the electric and gas utilities have, in fact, been reduced in market value over $200,000,000 relative to share values of other industries.

In fact, our company showed improved earnings for the period. The decrease in the value of our shares for that time amounts to over four years of dividends. This is the way it has already hit the shareholders, because of this.

The financial analysts of the company from time to time indicate that they will not recommend—they indicated to me personally—utility shares to investors at the present time, because of sections 4.63, 4.64 and 4.65 of the White Paper.

If those were removed, they would then recommend utility shares and they would expect a return to the normal place on the market. So, already in the study period, the shareholders of these utility companies, and many of them are small, and particularly our own company, have had at least four years of dividends taken off the value of their shares, because of these proposals.

The company, in presenting this brief today, is aware that it is also a party to a brief filed with this committee on behalf of all the investor-owned electric and gas utilities in Canada. It is also aware that the Canadian Electrical Association consisting of both investor-owned and government-owned utilities has communicated its support of the position taken by the investor-owned utilities. It is felt, however, that although the major points apply to all utilities across Canada, the impact of these points can be illustrated pretty clearly in the Nova Scotian situation.

Nova Scotia Light and Power Company, Limited operates in that province alongside The Nova Scotia Power Commission—a Government-owned utility, and generally speaking these utilities are nearly equal in size. The company has been able to operate, in

spite of paying full income tax, with rates to its customers for electricity certainly comparable to The Nova Scotia Power Commission and The New Brunswick Electric Power Commission, and, in some instances, less than the rates charged by The Nova Scotia Power Commission or The New Brunswick Electric Power Commission. The company's rates are considerably less than the general rates charged in the New England States and the Atlantic States. The company's allowable earnings and rates charged are completely regulated by the Nova Scotia Board of Commissioners of Public Utilities. The company also competes with other energy sources such as oil and bottled gas which in Nova Scotia are not regulated by the Public Utilities Board, nor are they affected by the proposals in the White Paper. Should the proposals of the White Paper be adopted, the company's position with respect to these competitors would be completely out of line.

The company has joined with The New Brunswick Electric Power Commission and The Nova Scotia Power Commission in forming what is locally known as The Maritime Power Pool. Under this contract the three utilities have agreed to generally pool their generating resources so that at all times the most efficient generating units are operating on the system. They have also agreed to take turns in installing generating plant to minimize the amount of spare capacity needed for the benefit of the three utilities. Nova Scotia Light and Power Company, Limited, under this agreement, was the first to install major generating plant under arrangement whereby it sold a portion of its capacity to The New Brunswick Electric Power Commission for a period of years until it was their turn to install new plant.

This Maritime Pool arrangement has been so successful that the utilities involved have even been able, on some occasions, to export power to the New England States. The Pool has also continually planned for the eventual interconnection with the Province of Prince Edward Island and Maritime Electric Company there, when engineering and economic studies indicate its feasibility. The proposals on tax reform would so affect Nova Scotia Light and Power Company, Limited that it would not be able to raise capital on sufficiently favourable terms—if at all, and could force the company to discontinue participation in the Maritime Power Pool.

The company is also well aware of the attitude expressed by government towards problems of inflation and the suggestion for curbing inflation made by the Prices and Incomes Commission. If the proposals with respect to paragraphs 4.63, 4.64, and 4.65 of the White Paper are deleted, then the Company feels without question that it will be able to maintain its present rate structure, which has been in effect since 1963 at which time an overall reduction in rates took place. It is suggested that this is an exceptional record when one considers that many of the larger government-owned utilities across Canada have increased rates to consumers during the same period, and, in some instances, on more than one occasion. Should, however, the proposals of the White Paper, be implemented, or if in fact an early indication is not given that they will be deleted, then the difficulties of raising capital for the Company will be such that it will not be able to maintain its present rates to consumers.

With respect to the impact of the Income Tax Transfer Act on Nova Scotia, the Government of Nova Scotia retains approximately half of these funds in the provincial treasury—the other half is distributed to the municipal governments in the areas served by the company, thus benefiting these consumers indirectly as citizens of the municipality. None of the rebated taxes come to the company or its shareholders.

The provincial government is also in the position under this arrangement that should it desire to assist the development of new industry through incentives on power costs, it could, from the funds retained in the provincial treasury, accomplish this without developing capital from its normal operations. So far the company has been sufficiently successful in its operations that it has been able to provide electricity to industry at rates comparable to those of The Nova Scotia Power Commission. Under the Public Utilities Act of Nova Scotia, the company is restricted from making special contracts with new industry that might be considered of a promotional or a special nature because, under the wording of the Act, they can be considered discriminatory. The Government of Nova Scotia has indicated to the company that it is considering legislation at this session which would facilitate the company making such special contracts, yet such contracts would still be subject to the approval of the Nova Scotia Board of Commissioners of Public Utilities. The company has indicated that it is quite prepared to offer rates comparable to those offered by The Nova Scotia Power Commis-

sion, or, if the Governments of either Nova Scotia or Canada desire in assisting economic expansion to make special grants to new industrial customers, such grants can be passed through The Nova Scotia Power Commission. This has already been done with grants previously available under the Atlantic Provinces Power Assistance Act.

Mr. Chairman, honourable senators, the company has attempted to provide considerable information in its Brief without becoming unduly wordy. We appear before you today prepared to substantiate the points brought to your attention in the Brief and to answer any questions that you may desire to put to us.

Mr. Rhude, as counsel for the company, has prepared a schedule showing the pertinent part of the Income Tax Transfer Act and its actual effect, showing some of the figures there. If it is your wish, Mr. Rhude is prepared to proceed.

Senator Isnor: Mr. Chairman, I should like to ask Mr. Harrington if the rates he mentioned are controlled in any way.

Mr. Harrington: The rates that we charge consumers are in all instances set by the Board of Commissioners of Public Utilities, which is a government-appointed commission in Nova Scotia. We are not allowed to set any rates ourselves. Our earnings are completely controlled under the terms of that act at what they consider in their judgment to be just and reasonable, and all of our operations must be subject to the control of that government-appointed commission, the Board of Commissioners of Public Utilities of Nova Scotia.

Senator Isnor: Is the Nova Scotia Power Commission, your competitor, subject to the same regulations?

Mr. Harrington: The Nova Scotia Power Commission, which is a public, government-owned electric utility, operates under is own act and is responsible only to itself and does not come under this regulation.

The Chairman: The only part of that, senator, that we are concerned about is that they don't control their own rates.

Senator Isnor: But they do.

The Chairman: They cannot adjust rates to meet whatever the exigencies might be. They have to go before a provincial body.

Senator Isnor: That is true with respect to the Nova Scotia Light and Power Company, Limited, but it is not true with respect to the Nova Scotia Power Commission. They are not compelled to do that.

The Chairman: I would expect that they are subject to the same rate structure, are they not?

Mr. Harrington: No, sir. They have quite a bit more latitude. They are a government commission under a special act, and as set up in that act the Nova Scotia Power Commission has the privilege of setting its own rates.

The Chairman: In practice, how does it work out?

Mr. Harrington: It has worked out, generally, that our rates are comparable; in the domestic field our rates are somewhat less, in fact, and in many of the industrial power rates again our rates are somewhat less. They have recently contracted a few special contracts with new industries that are somewhat less than ours, because, by legislation, we have not been able to compete with them in that field. However, that legislation is now being changed so that we will be able to compete, still under the control of the Board of Commissioners of Public Utilities. I am sure we will attempt to have our rates less again.

The Chairman: Over the whole period of the tax rental agreements, the period when this rebate of taxes was included in the Estimates, and then in the period so far under the Transfer Act where the moneys had gone to the province of Nova Scotia presumably as a refund of taxes collected from the privately-operated companies, no part of that was distributed to your company?

Mr. Harrington: That is correct, sir. As a matter of fact the provincial government has requested these refunds over the years—and I am aware of some of their submissions in this respect—thinking of the discrimination as between provinces and particularly feeling that these monies should be available to them in Nova Scotia because Nova Scotia had different systems from those in other provinces.

The Chairman: Any questions?

These provisions are referred to in the White Paper, and Senator Flynn wanted to know what was the reason for them.

Senator Flynn: I think I now remember exactly what happened. It was in 1962 when

there was a debate in the Province of Quebec over the nationalization of the private power companies and the argument was put forward that it was in the interests of the province to nationalize these because they were paying taxes to the federal government, whereas public-owned Quebec Hydro was not, and by nationalizing them there would be a net gain. The companies complained that it was an incentive to the provincial government to nationalize the companies, and I think that is why the transfer was made at that time.

The Chairman: If you read the debates of that time, as I did, you will find that what was said in 1962 was not said in 1966. In the earlier years they said what you are now saying, that the intent was to assist privately operating companies. I think it is significant if you look at the reasons which the White Paper purports to give. First of all they state the principle of the White Paper on the question of dividends. They say:

> The whole scheme of the present proposals contemplates that shareholders of Canadian corporations receive a credit from the federal government for part or all of the federal corporation tax paid by their corporation.

That is the general principle which runs through the White Paper. But then they say:

> It would be contrary to this general scheme if the federal government gave to shareholders of these utility corporations credit for taxes which the federal government has turned over to the provincial governments, and it does not propose to do so.

Now if there was ever a non-sequitur, this appears to be it, because the distribution that takes place under the taxation agreements represents taxes collected from corporations and individuals, so that on that basis to be logical you would have to deny a tax credit since it is a distribution of funds which the federal authority has collected in taxes. It would have to cancel out the principle of tax credits. Of course, as I have said more than once, you should not expect logic in taxation.

Senator Lang: My colleague suggests that the real reason was that the shares were depressed, and as soon as the White Paper is finished with, they will be ready for capital gains tax.

The Chairman: Mr. Benson will get it one way or the other. They had better hurry along with the evaluation date.

To illustrate the other point being made here, the concluding paragraph of these three paragraphs in the White Paper says:

> It would be possible...

on the basis of the 95 per cent rebate—

> ...to give the shareholders credit for the taxes which the federal government retains.

That is the 5 per cent.

> However, the amounts would be very small and the government considers it more efficient to ask Parliament to amend the Public Utilities Income Tax Transfer Act so that all of these taxes are turned over to the provinces, who could then decide to what extent they should be turned over to the corporation or its shareholders.

So this is still preserving it as a non-conditional transfer of tax funds by the federal authority to the province.

Senator Hays: It does not mention the consumer.

The Chairman: No.

Senator Hays: It is the shareholders or the company.

The Chairman: The company or its shareholders.

Senator Hays: May I ask Mr. Harrington a question. When this act became law, did you negotiate with the province at all in suggesting that you would like to pay this back to the consumer?

Mr. Harrington: Yes, sir. I would not say we negotiated, but the Government of Nova Scotia was well aware of the fact that the utility companies are on the record at the time of the Income Tax Transfer Act as making submissions to the government over a long period of time with respect to the discrimination between the utilities and the investors. Back as far as 1947 when this was first taken up—and I think it might be useful to know that in 1947 it was first introduced as a transfer by the then Minister of Finance, Mr. Abbott—after Montreal Light Heat and Power Consolidated was taken over by the Province of Quebec, it was felt that the main reason for taking it over was because taxes were being paid to the Government of Canada at that time. Mr. Abbott agreed to pay 50 per cent rebate of taxes. However,

since 1947 taxes have changed and the earnings of companies have changed very materially, so that the amount of dollars paid by investor-owned utility companies since 1947 again reached an amount large enough in scale that provincial governments were being embarrassed and saying "look at the amount of money going out of our province. If we were to nationalize the utility, this money would not be going out of the province." This was the main reason. Some of us have been successful in meeting the competition of government-owned utilities, but it was a question of the discrimination as between provinces that bothered the provincial governments.

When the Transfer Act was passed in 1966 we were called by the Government of Nova Scotia to discuss with them as to what would be a fair method of distribution. They indicated to us that while our rates were somewhat lower than those of the Nova Scotia Power Commission, they would be somewhat embarrassed by having to pass this back to the consumer and they also held up part of the tax since 1947 in their general treasury which they did not want to give up. If they had given up half of this under the 1966 act, it would have represented something like 10 per cent of a reduction to the consumer.

Senator Hays: Had you ever said that this was what you proposed to do?

Mr. Harrington: No, sir. In our representations to the Government of Canada throughout the years, we said we were not speaking because the company wanted a reduction in taxes but we felt that the provincial government itself would be embarrassed by the fact that the money was going out of the province because of the way they were running things.

Senator Hays: Would you have preferred to give the consumer a reduction?

Mr. Harrington: We would not have had any choice. It would have been the same regardless of what we did and I do not want to claim purity in this matter. They would have told us what to do because we would have had to reduce our rates to maintain our earnings at a rate which we considered reasonable.

Senator Hays: What would you have liked to do with it?

Mr. Harrington: In fact we had agreed with the Province of Nova Scotia to return, as they did, the extra amount to the municipal government of the area in which we served because the benefit was given indirectly to the consumer. In Nova Scotia, as you may have heard from the Maritimes, they have been seeking to bring up the economic base through every means, and the municipalities in Nova Scotia are hard put to meet their requirements of services and, this new word, the infrastructure. They are hard put to do it under the tax base available to them, and this was the means we saw of assisting the municipalities and our consumers in the area.

The immediate impact of that is that the town of Truro, in Nova Scotia, ran a municipal commission distributing electricity, which it bought from the Nova Scotia Power Commission, to its own people. When this happened the town of Truro put their municipal utility up for tender, and the Nova Scotia Light and Power Company tendered for it and our company was successful in purchasing it. We were told by the people in the town of Truro that one of the influencing factors was because of the taxes which would be paid by our company in the normal way and the rebate they would get out of our earnings coming back from the provincial Government would make this a very favourable thing and was one of the reasons why they sold. This was a thing that was hitting the municipalities, and the town of Truro wanted to cash in its asset of the utility company because they had to put about $3 million of municipal financing on a large new high school, and by selling this utility to us and getting the rebate of taxes under the Income Tax Transfer Act it put them almost in the same position, as far as the town's revenue was concerned, as they were when they operated the utility themselves, and they were able to devote funds in the public sector to the public infrastructure, leaving the utility, which under normal circumstances has been successful, to raise its own funds.

The Chairman: The neat point is that up until now the shareholders of these privately operated public utilities, when they received a dividend, got their 20 per cent tax deduction. This White Paper proposes to take that away, and they will have no tax credit.

Senator Hays: I realize that, but I remember well when these proposals were put forward over the years, where one province paid a rebate each month, and the company rebates it on the utility bills. I remember it so well and it was hoped that this is what the

provinces would do with the money, so that it could in turn be turned back to the consumer.

One other point. You were talking about the reduction of the utilities shares. Do you know what the reduction in the United States on utilities shares is? You say the White Paper has caused this great reduction.

Mr. Harrington: Yes, the shares on the markets generally have not been that good anywhere. Utilities shares in the United States have fallen and have generally kept in parallel with shares of other industries and corporations.

The thing that is dramatic in the Canadian exchanges—the Montreal and Toronto exchanges where our stock is listed, for instance—is that on November 7 there was an improvement in the value of all industry shares generally which was credited as being because of the White Paper. There is a chart attached to our brief, and also to some of the other briefs, showing that on November 7, if you take the index then as being 100, the general index and the Toronto Stock Exchange industrial index moved so that, according to our latest information in mid-January, it was running in the area that this 100 would average out at an index of about 102 or 103. Whereas the utility companies, however, in opposition to that, were carrying somewhat parallel before and suddenly they dropped down so their index in the middle of January was about 85.

Senator Hays: They have done the same sort of study in the United States?

Mr. Harrington: No, because there has not been the same dramatic difference between utilities shares and the fall in the general market. We have examined the United States market, and utilities shares followed the ups and downs of other industries, whereas in Canada we suddenly divert from them.

Senator Gelinas: I see in the brief that there was a bond issue contemplated when the brief was prepared. Has that issue been sold?

Mr. Harrington: Not completely, and we were not able to sell it in the normal market. As a matter of fact, we found the market was so difficult because we were arranging the bond issue before the White Paper, and when this came up it created great difficulties for us. We knew the provincial Government had certain pension and superannuation funds with regard to which it would redeem securities for sinking fund purposes and other things, and we asked them, on the basis of fair market value, would they be prepared to invest some of the funds, from the securities turned over in the superannuation fund under their control, in ours, because we said we had great difficulty in approaching the normal institutions, and they were not interested in buying that bond at that time at all.

Senator Gelinas: It was not a question of rates?

Mr. Harrington: The actual issue was for $6\frac{1}{2}$ million, and there have been $2,800,000 sold to the provincial Government in this way, and we feel we will be successful because they have these turnovers coming up every six months or so, and it will take us six to eight months compared to the normal procedure. We think we can get it, but only because of the particular realization by them that we were in difficulty and there is this means of assisting us without hurting themselves.

Senator Hollett: Supposing the White Paper goes into effect, will you have to raise your price to the consumer?

Mr. Harrington: As is suggested in this clause, yes, we will.

Senator Hollett: In other words, the consumer will be hurt?

Mr. Harrington: Yes, that is right.

Senator Flynn: I just wanted to put it in a nutshell. Presently, the situation is as follows. As far as the federal Government is concerned, from a publicly-owned corporation it does not get any corporate tax, and it does from the privately-owned, but it transfers it to the province to the extent of 95 per cent, and now proposes it to be 100 per cent. As the publicly-owned companies do not distribute any dividend, the federal Government does not get any income tax on any dividend or any surplus from a publicly-owned company?

The Chairman: It should go into a rate reduction.

Senator Flynn: But when you have a privately-owned company distributing dividends, it wants to increase the tax by disallowing the 20 per cent deduction, is that it?

The Chairman: You remember the White Paper substitutes for the 20 per cent deduction from tax what they call a tax credit.

Senator Flynn: But they disallow the credit in this case?

The Chairman: That is right.

Senator Flynn: In fact, it is an increase in tax with regard to a special class of shareholders, without apparently any justification.

The Chairman: And is contrary to the principle of the White Paper on this point.

Senator Flynn: Yes.

The Chairman: Are there any other questions?

Senator Burchill: I should like to ask Mr. Harrington about the respective performances of the Commission and the Power Corporation. Does the Nova Scotia Power Commission have to go into the rougher places, as I would call them?

Mr. Harrington: They have suggested over the years, sir, that they have to go into the rural areas, but so do we. Many years ago there was an act passed in Nova Scotia called the Rural Electrification Act, under which the Government of Nova Scotia assisted by means of direct grants, both the power commission and the municipal utilities to extend into the sparsely populated rural areas. Many years ago we said to the provincial Government that we do not need assistance for this type of thing; that we would go into the rural areas without any assistance. Of course, we do have large centres such as Halifax and Dartmouth on our system, but they also have large centres such as Sydney, Sydney Mines and North Sydney, and they have the settled areas in Pictou County. So, basically, I do not think they can make out a case for this. In the past there may have been some instances of where assistance was called for, but today we are neck and neck, and it is a competitive situation. It is embarrassing for me to say too much more about it.

Senator Burchill: I am trying to compare the performance in Nova Scotia with that in my province of New Brunswick.

The Chairman: Mr. Rhude, do you feel that you need to develop this point that you were prepared to develop?

Mr. H. B. Rhude (Counsel, Nova Scotia Light & Power Company Limited): Perhaps not, Mr. Chairman, but I would like to comment on Senator Flynn's first remark concerning the purpose for which the Public Utilities Income Tax Transfer Act was passed. Is it appropriate for me to do that now?

The Chairman: Yes.

Mr. Rhude: Mr. Chairman and honourable senators, with respect to Senator Flynn's opening remarks concerning the reason why the Public Utilities Income Tax Transfer Act was passed I think the best source of that information is in a statement made by the Honourable Mitchell Sharp, the then Minister of Finance, on June 23, 1966, in which he said:

> Prior to and at the federal-provincial conference of prime ministers and premiers held in July last year many provinces argued that privately-owned gas and electrical utilities were still at a competitive disadvantage vis-a-vis publicly-owned utilities, and that this disadvantage inhibited the private companies from developing new power sites necessary for Canada's requirements. They also expressed concern that because of this differential treatment the customers of the privately-owned utility companies were similarly placed at a disadvantage. Furthermore, it was argued that this disadvantage was felt most in those provinces which depended on private companies for the generation or distribution of electrical energy and gas and that the continuation of this disadvantage would oblige the provinces to consider the nationalization of these utilities.

He continued:

> The Government of Canada was obliged to acknowledge, after careful consideration, the force of the provincial argument as to the effect upon the consumers of electrical energy and gas of the differential treatment of utilities.

During the debate on the resolution introduced by Mr. Sharp, and while the house was considering the matter in the committee of the whole, an amendment was proposed which, had it been accepted by the committee of the whole, would have limited the transfer of the income tax under the Public Utilities Income Tax Transfer Act to provinces which agreed "that such amount will be applied to reduce rates paid by customers of the respective designated corporations."

A few days later, as the debate proceeded, Mr. Sharp commented on this, and said:

> This proposed amendment would substantially alter the nature of this legisla-

> tion. May I say to the hon. member who has proposed it that he is really calling in question the value of public opinion in the provinces of this country. After all, the purpose of this legislation...

And here he was saying what the purpose was in his mind, and he was the minister charged with the responsibility of introducing the bill.

> ... is to avoid giving an artificial inducement to any province to nationalize its public utilities; that is the purpose of the bill.

If you consider that that was the original purpose of the Government's introduction of the bill, and if you consider that that is still the purpose, then our position is that it was a sound purpose at that time to place the Nova Scotia Power Commission and ourselves in a position of tax neutrality, and of not creating any inducement to nationalize. If that was the purpose then it is negated in large measure by this provision in the White Paper, because by making it more difficult for the company to finance and to serve its customers, by almost forcing the company over a period of time to raise its rates, it is creating this inducement, or artificial stimulus, as the Minister of Finance called it, to nationalize us.

Senator Flynn: And the result would be a net loss to the federal treasury of the income tax on the dividends?

Mr. Rhude: We believe that is so, and that is what the Minister of Finance thought at that time.

Senator Flynn: Instead of getting more the federal treasury would get less, if the result is that as outlined by the witnesses?

The Chairman: Yes.

Senator Lang: I take it from what this witness is saying that the policy behind the White Paper is the reverse of the policy which brought this act into effect? In other words, these utilities will more likely be nationalized?

Mr. Rhude: Yes, sir.

The Chairman: Are there any other questions?

Senator Isnor: I should like to ask Mr. Harrington in respect of his expansion plans. He mentioned the difficulty of obtaining loans.

Mr. Harrington: Yes, the company at the present moment has a new generating station under construction which will cost about $17 million. This plant is due to come into production in the summer of 1972, and associated with it are all the other necessary transmission facilities. This means that over five years beginning in 1970 we must spend between $50 and $60 million on a new plant and transmission and distribution lines. It is quite a burden on the company to finance this, considering the fact that at the same time we, like so many other companies, are being caught in the squeeze of low interest rates of 20 years ago and the high interest rates of today. Many of the company's bonds were put out some 20 years ago, and in this five-year period we have three or four of those issues maturing, which we must refinance. The company must restrain itself and not become dramatic about the whole thing, but I can just see this expansion program being impossible to achieve if these proposals go into effect.

Senator Isnor: What effect do the proposals in the White Paper have on that?

Mr. Harrington: The proposals in the White Paper will put us into the position on today's market where we feel, from the information we have, that we cannot successfully market a bond issue without some kind of equity participation. This seems to be the type of bond issue that would bring money to the company at reasonable cost. But, because of the impact of our equity, and because of the general feeling amongst financial institutions and financial analysts that utilities stocks are not ones that they will recommend right now, we are being put in the position where we wonder whether we can finance at all, no matter what the rate is.

The Chairman: Your convertible issue would not be attractive?

Mr. Harrington: It would not be attractive, and we could not afford to give an attractive rate having regard to the manner in which the value of our shares has gone down and it would now be considered to be below the normal for a company with a strong economic base.

Senator Beaubien: What is the price of your shares now, and what was the all-time high?

Mr. Harrington: The all-time high was $13 on the present basis of shares. I do not know exactly what the price is today, but it has been floating around $7.

Senator Beaubien: What is the yield?

Mr. Harrington: There is a dividend of 40 cents, so it would be just under 6 per cent at $7.

Senator Beaubien: When was the all-time high at $13?

Mr. Harrington: Two and a half or three years ago.

The Chairman: If there are no other questions and you feel that you have nothing more to say, I would like to thank you very much for your appearance.

Mr. Harrington: Thank you very much for your courtesy, sir.

Senator Laird: Could one of the witnesses, during the hearing this morning, give the committee some idea as to the relative number of private utilities as compared to public utilities in Canada, and the relative size and energy generation so that we can get some sort of ratio?

The Chairman: We may get that from the next group, the Canadian Gas Association. We will find it somehow. Order, please.

The next group is the Canadian Gas Association. We have Mr. Bovey, who is the President, Mr. Maybin, Chairman and Chief Executive Officer of the Canadian Utilities Limited, Mr. Hurst, who is Vice President—Finance, Consumers Gas Company Limited and Mr. Phillips, Q.C., who is the Counsel. Would you please come forward?

Mr. Edmund C. Bovey, President, Canadian Gas Association: Thank you very much, Mr. Chairman and honourable senators for giving us this opportunity to share with you in some of our concerns regarding the implications of the White Paper. The chairman has identified our group here this morning. I do not propose to take too much of your time in repeating the Canadian Gas Association brief, because essentially in every respect we support the position that Mr. Harrington has outlined to you this morning. If you will consider simply that I am representing a number of shareholder owned gas utilities in Canada, rather than Nova Scotia Light & Power Company Limited, you will see the picture better. There are one or two things that I would like to emphasize. One of them is the urgency of this situation in regard to shareholder owned utilities and the continuing demand that Mr. Harrington has so well explained for raising capital and for growing in line with the growth of our great country. We must keep raising money, regardless of the conditions, therefore there is a real need for urgency.

You have received a copy of our brief and I will just quickly emphasize one or two sections by reading them to you.

Senator Connolly (Ottawa West): Would you identify the pages, please?

Mr. Bovey: Yes, sir. I will now read from page 1, "New Capital and Market Reaction":

> These utilities frequently require substantial amounts of new capital to meet the rapid growth in consumer demand for natural gas. The total investment currently is in excess of 1.5 billion dollars. The timing of financing for these highly capital intensive utility companies is not a matter of choice but is dictated by the growth of their service areas. With the bond market virtually closed by extremely high interest rates, the only other sources open are convertible debt securities and equity financing. The proposed changes would lower the price obtainable on the sale of such securities to the public and would inhibit the availability of these funds. Either alternative can only end up hurting the customer either in higher rates or reduced service.

If I may then direct you to page 3, under the heading of "Economic and Tax Objectives":

> A main objective of tax reform is stated in the White Paper to be that the tax system does not interfere seriously with economic growth and productivity. "Taxes by their nature cannot always promote all our economic goals, but they should interfere as little as possible with incentives to work and invest and with the directions our economy follows in meeting demands of consumers and foreign markets". In short, in the absence of a need for incentives to further social policy, taxes should be neutral. Investments needed for productivity and public purposes should not be rejected in favour of less desirable alternatives just because of their tax consequences. The investor-owned gas distribution utilities provide a vital public service. The adverse effect on financing of gas distribution utilities resulting from the proposals is inconsistent with this stated objective.
>
> It is intended that the tax burden be distributed fairly which means that "peo-

ple in similar circumstances should carry similar shares of the tax load". The tax reform proposals would impose a heavier tax burden on shareholders of investor-owned electric, gas or steam utilities than that carried by shareholders of other Canadian business. This is inconsistent with the stated aim for fairness in taxation.

To maintain the fair value of presently outstanding shares and attract new equity funds, the after tax yield to shareholders of these utilities must be equivalent to that available through alternative comparable investments. One might suggest that gas rates to consumers could be increased to offset the effect of the denial of the tax credit to shareholders. The rate of return from utility operations would have to be increased to a level substantially higher than the maximum rate of return presently allowed by regulatory authorities.

The Chairman: I presume what you are saying in effect is that you could increase your rates sufficiently to compensate the shareholders for what they lose under the White Paper?

Mr. Bovey: This is true, Mr. Chairman, provided the regulatory authorities in the various jurisdictions, which Mr. Harrington and our companies have to deal with, would allow a sufficiently high rate of return.

Senator Connolly (Ottawa West): You are controlled in that?

Mr. Bovey: Yes, indeed, sir.

Senator Laird: Your profits do affect your rate structure, do they not, with the regulatory bodies within the ambit of their formulas?

Mr. Bovey: Yes, indeed, senator. You might put it the other way, the rate structure affects our profits.

Senator Laird: Yes and vice versa. Does it not interact? Theoretically, if your profits were so bad you could go back for the rate increase with very good arguments.

Senator Connolly (Ottawa West): By the same token, if you had unduly large profits they would probably cut you down on rates.

Mr. Bovey: Unless there was a complete change in the philosophy in the regulatory figure. There is a trend in this regard, due entirely to this current high cost of money situation, which is more than current now. It has been with us for some 18 months and some regulatory authorities are recognizing this in their deliberations.

The Chairman: I suppose you could say that the profits, in relation to the rate structure is the governor?

Senator Laird: In other words, the effect of these proposals utlimately is going to fall on the consumer.

Mr. Bovey: Indeed, in this context.

The Chairman: If you want to raise money, and can raise your rates to do that, then the consumer is going to pay more. He is going to pay the shot.

Mr. Bovey: There is also the problem of increasing earnings or profits to the extent needed to reimburse the utility shareholder, and the present implication is that he will not be allowed to gross up. There are some real numbers involved here, and I will ask Mr. Hurst to comment on that in a moment. The numbers are quite difficult to build him up so that after his tax treatment the utility shareholder will do as well as another Canadian shareholder.

Carrying on then with page 4 we come to the matter of the confusion of transfer payments with taxes, a subject which has been dealt with to some extent by previous witnesses. I should like to say that the proposal that shareholders of investor-owned electric, gas or steam utility corporations in all likelihood will not receive credit on dividends rests upon the justification that 95 per cent—the White Paper proposes 100 per cent—of the taxes paid by these corporations is now being turned over to the provincial governments under the Public Utilities Income Transfer Act. This act was enacted so that these utility companies and their customers could be placed upon a more equitable basis with government-owned utilities. The provincial governments, in turn, could effect the desired equity by rebating amounts equal to the tax to the various corporations.

The intention of this act was that taxes rebated to the corporations would be passed on to the consumers. I think Mr. Harrington and his group stressed that point.

Another observation, Mr. Chairman, is that this Public Utilities Income Tax Transfer Act and its application by certain provinces was extremely important to the success of the great Churchill Falls Brinco operation. There

was a need in there, as I understood it, for a rate situation that would make that viable, and one of the provisions enacted here meant that some of the rebate in taxes to the provinces flowed through to the utility consumer in that situation.

Senator Connolly (Ottawa West): The financing of the Churchill Falls operation was predicated upon the continuation of the Public Utilities Income Tax Transfer Act, was it not? That act had a definite bearing upon the financing of the Churchill Falls operation.

Mr. Bovey: Yes, that is right.

Senator Connolly (Ottawa West): And now that rug has been pulled out from under them.

The Chairman: No. The rug is not being pulled away. That statute still remains, but the existing 20 per cent tax credit that shareholders get is being pulled away so far as shareholders of public utilities are concerned, and they don't get compensation by way of a tax credit.

Mr. Bovey: I should point out that on page 5 it says that it must be clearly stated that investor-owned gas distribution utilities do pay Canadian income taxes. The denial of the tax credit to their shareholders results in a degree of double taxation on the corporate income.

Under the heading "Provincial Determination" it says at the bottom of page 5 that the White Paper philosophy, by failing to assure that a tax credit be available to gas utility shareholders, unfairly projects investor-owned gas distribution utilities into the midst of federal-provincial fiscal discussion where they ought to have no standing.

Those, honourable senators, are just the points I wanted to stress so far as this brief is concerned.

The rather paradoxical situation that develops, if the White Paper provisions prevail, is that a foreign shareholder, or a person in a foreign country that has a tax agreement with Canada, such as is the case with the United States, is much more favourably treated through buying shares of my company, or of Mr. Harrington's company, than are our Canadian shareholders. I might say that I signed an underwriting agreement on behalf of my company yesterday in New York for the issuance of 1,325,000 shares of common equity of Northern and Central Gas Corporation. So I dare say that it is a reasonable statement on my part that, to a certain extent, equity shares of our corporation are a little more acceptable in New York at this point than they would be in Canada. We talk of wanting to retain ownership of our great utilities and other companies in Canada, but here is a situation that, if anything, is encouraging the sale of equity off-shore, shall we say. Mr. Phillips will say a word on that in a moment.

One of the senators raised a question a moment ago with respect to utility stocks, and, actually, in the past five to six weeks American utility stocks on average have increased about 20 per cent of value. That was mentioned yesterday in New York. I think it ties in with the question asked of Mr. Harrington. Here are a group of utility stocks that are increasing. Certainly, there is no reaction of that nature in Canada at the moment.

Senator Hays: You say up 20 per cent?

The Chairman: In New York.

Senator Isnor: That is the American market.

Mr. Bovey: Yes, that is American utility stocks, sir.

Senator Connolly (Ottawa West): The reason you are saying that is that the demand for power in the United States is recognized to be such that the value of the stocks of these companies that produce it is going up.

Mr. Bovey: There are one or two considerations. We talked a few moments ago about regulations. I will be brief. The United States regulatory authorities are starting to recognize the increased costs of all kinds that their utilities are having to contend with, including the cost of money and rate increases, and so on. The *Wall Street Journal* every day shows about five of them going through, and these rate increases are becoming successful. It comes back to the point Mr. Harrington made that when the investor sees there is an assurance of better return or continuing return he starts again to put money into that segment of the market that is attractive.

Mr. Chairman, may I ask Mr. Hurst to comment, if he would, on this matter of the difficulties in the problem of flowing enough money through to our shareholders to off-set...

Senator Connolly (Ottawa West): May I ask a general question first? If the situation in the

United States as projected indicates, if not a power shortage, a potential power shortage and probably a higher cost for power, would that same situation obtain, would you say, in Canada?

Mr. Bovey: I really should not speak for the electrical industry, senator, but I think in general the answer would be yes.

Senator Connolly (Ottawa West): The demand is ever increasing.

Mr. Bovey: And the more economical sources of generation are being used up and you move to nuclear generation and so on.

Senator Connolly (Ottawa West): Thank you.

The Chairman: We will now hear from Mr. Hurst.

Mr. F. Warren Hurst, Vice President, Finance, Consumers' Gas Company Limited: Thank you. Mr. Chairman, I expect Mr. Bovey asked me to speak because he knew that for four years I was on loan to the Ontario government attached to the Royal Commission studying provincial taxes.

In relation to the specific point on ways in which moneys can find their way back to the shareholder, as might be contemplated, there are really only two channels. One would be for the province to rebate the moneys to the companies, and this is the one that is made reference to in the White Paper, and for the companies then to return these moneys to the shareholders. This creates a very significant problem, largely because of the timing delay, the three years mentioned by Mr. Harrington earlier as the time between the payment of income tax by a company to the federal Government and then its return to the provinces. So that the group of shareholders that ought to be rebated would be changed somewhat three years later from the group that originally would have presumably had the right to receive that money. So that companies would have to keep two dividend lists—a list of the current shareholders and a list of the shareholders on hand three years ago at the time the original tax payments were made federally.

The Chairman: Would you have to do that? The dividend only becomes an obligation when you declare it, and whoever qualifies as a shareholder is the one entitled at the moment of declaration.

Mr. Hurst: That is correct, but I think the tax credit system proposed is different from the 20 per cent dividend credit, so you really are relating back to the tax paid by the corporation at that time.

Senator Beaubien: There is no real reason why it would be a delay of three years.

Mr. Hurst: When we were studying the provincial taxes of Ontario we tried to find out what it was, and I really cannot say we have established a good answer on that. I believe there are certain reasons related to the opportunity for appeals and discussions of that sort to come along, so we do not really know the actual amounts to the last dollar until a number of things have been worked through.

The Chairman: Mr. Sharp, in explaining a bill in 1966, gave this explanation on that point:

> Honourable members will note that there is a delay of approximately two years between the taxation year in which the profits are earned and the year in which the 50 per cent share is paid to the provinces.

He was talking about the time when it was 50 per cent.

> Aside from the time lag allowed all corporations in the filing of their tax returns, further delay is occasioned by the need to identify those corporations in respect of which the 50 per cent sharing arrangement applies and then to re-process their tax returns to determine the amount of tax revenues to be shared and the province or provinces to whom payment is to be made.

That is a lot of words, with all due respect to Mr. Sharp, but I am sure that with the computer systems they have there may be a little bit in there to do with the use of the money in the meantime.

Mr. Hurst: I think perhaps you also recognize the corporation tax payments have been accelerated too, so it is more like three years now.

The Chairman: If there were more than 12 months in the year you would be paying even more.

Mr. Hurst: The other channel of distribution would be for the provinces themselves to make the tax credit available to the shareholders. I believe in most of the provinces in

Canada there are no direct personal income tax returns given to the provinces. This would be an extremely difficult job for any province to try to undertake in the absence of their own personal income tax forms being presented. So, the only practical way—and I think this would be agreed to by people involved at the provincial level—to make it available would be for provinces to authorize the federal Government to make a rebate at the time the income tax returns are handled through.

Senator Burchill: How is it working out in Alberta, where they have passed legislation?

Mr. Hurst: I do not believe Alberta has. Do they, Mr. Maybin?

Mr. John Maybin, Chairman and Chief Executive Officer, Canadian Utilities Limited: There is no personal income tax return in Alberta, and the way it is working in Alberta is that the rebate, in fact, is going back to the consumer.

Senator Hays: That is where it should go to.

Mr. Hurst: In other words, the cost of gas to the consumer has been reduced, in effect, in Calgary by 8 per cent for a person who is a resident, and in Edmonton by 8½ per cent, and as a result the income tax money is being transferred in Alberta, and through legislation which exists in Alberta it is effectively going back to the consumer.

The Chairman: The White Paper does not contemplate it going back to the consumer.

Mr. Hays: There is no reason why things cannot be changed, and that was the original intention of the act.

Mr. Bovey: Perhaps Mr. Phillips might be allowed to comment.

Mr. Neil F. Phillips, Q.C., Counsel, Canadian Gas Association: Thank you, Mr. Chairman. Mr Bovey mentioned that the difference of treatment of non-resident shareholders from resident shareholders is a very real thing. The White Paper itself, section 4.49, suggests that the whole tax credit procedure does not apply to non-resident shareholders. So with a treaty country like the United States—and let us take the United States as being the most logical example—there is a 15 per cent tax on dividends, and the fact that public utilities may be treated differently from Canadian domestic shareholders is a matter of indifference to the United States shareholders. Therefore, as shares have fallen on the Canadian market they have become, conversely, relatively attractive to the American buyers. But when you talk about ordinary purchases across the board on the exchanges, there is a most serious point that comes up, and the real point I think is the fact that if control is acquired, or a large position, by a United States company, the position is highly advantageous, much more so than to people owning small blocks of stocks in utilities.

I cannot speak authoritatively, but under the U.S. law as it now stands, if a corporate recipient of dividends from a foreign corporation has more than 10 per cent of stock of the company, it not only gets credit for withholding tax but also for the corporate taxes paid by the declaring company. The way the United States income tax law is structured, they do not distinguish, as the White Paper does, between whether it is paid to the federal Government or the province, or to the federal Government and turned over to the province. I use the term "control" loosely because it happens to be that 10 per cent qualifies, but if it is good for 10 per cent it is good for more. It makes it highly desirable for United States investment companies to attempt to acquire control of Canadian utility companies, in the sense of taking 10 per cent or more, because they get highly advantageous credit on both the withholding tax and the corporate tax.

The White Paper makes a statement which, with your permission, I would like to read.

Senator Hays: On what page?

Mr. Phillips: It is on page 54, the last sentence of Section 4.49;

> Because the general tax rule in other countries does not include a credit to the shareholder in respect of taxes paid by the corporation, it is not necessary for Canada to enact such a provision, and it would be quite expensive to do so; an expense that would have to be borne by the Canadian taxpayers.

This is dealing with another aspect, but I respectfully submit that while, if you counted noses on a broad country basis, it is a true statement and if you take into account small shareholders it is also a true statement, nevertheless it is not a true statement in what is far and above the most important area, which is that United States companies that

take more than a 10 per cent position in Canadian companies do get this credit for the corporate taxes paid by the Canadian company. If by the provisions of the White Paper—and perhaps I am saying more than I should as counsel—Canadian companies are subjected to the rules of 4.63 and 4.65, with the evident dislike that the investing public must have for their shares as compared to other companies', and the consequent drop in market value, which is self-evident even before the legislation, you have the anachronistic result that this makes them all the more desirable to U.S. corporate control, which I presume is hardly what the framers of the White Paper desire.

Senator Laird: Since you have mentioned the adverse effect on Canadian shareholders I would ask you if you have any means of knowing what kind of person invests in companies of this type. Are your investors mainly people with small incomes, or have you any means of knowing this?

Mr. Phillips: I do not have any statistics on it.

Mr. Bovey: These are not accurate statistics but, generally speaking, utility stocks have attracted people who are looking for a stable and secure investment with income. We call the stock "widows' and orphans' stock".

Senator Laird: Have you any idea of the numbers involved in the overall picture?

Mr. Bovey: I had some work done on this. I cannot speak in totals, but in our own company we have something like 26,000 shareholders, and I would say that about 90 per cent of them—I do not suggest that 90 per cent are widows and orphans—are people looking for a good return and a safe investment. If you multiply this figure by the thousands of other shareholder-owned utilities then you will have some idea of the total.

The Chairman: Have you anything further that you would like to say?

Mr. Bovey: No, thank you very much, Mr. Chairman.

Senator Connolly (Ottawa West): The stock is almost in the category of a trustee investment prescribed by the laws of Ontario?

Mr. Bovey: Yes, indeed.

Senator Connolly (Ottawa West): And with some potential growth?

Mr. Bovey: Yes.

The Chairman: Mr. Hurst, you are going to stay and make some further comments, are you not? Mr. Hurst is the Vice-President—Finance of Consumers Gas Company Limited, and he has some additional comments to make on behalf of that company.

Mr. Hurst: Mr. Chairman, I believe the members of your committee have a copy of the separate and very short brief of The Consumers' Gas Company. I would like to make reference to one or two points in it. Incidentally, you will see that we have attached to it a copy of the Public Utilities Income Tax Transfer Act, which we have been discussing so much this morning.

The first point I would like to make is contained in the first paragraph where we have indicated that we have actively supported the work of the Canadian Gas Association, and I do not propose to go over in any way the points that have been made already, but we do, as a company, wish to add to them because of the fact that we are fairly sensitive in this area. There are several reasons for that.

First of all, we do operate gas distribution systems in two provinces of Canada, namely, Ontario and Quebec, and we also operate a gas distribution system in the State of New York. This means that when the discussions that Mr. Harrington mentioned this morning take place with a province, in our case they have to take place with two provinces, and, of course, we have also to be concerned with our operation in the State of New York, which is just across the St. Lawrence River in the area of Messina, Ogdensburg and Potsdam.

The second thing is that in Consumers Gas we are becoming increasingly interested in what you might call non-utility activities. We tend to get into this because of the many contacts that we make with builders, developers and people of this kind. So, the day may well come when the Consumers' Gas Company—and I think this is not unlike what is happening to many other utilities—may find that increasing proportions of its revenue, would not be the subject of this particular group of sections we are talking about in the White Paper, and, of course, this leads to complications.

In the lower half of the first page we have raised the same point that Mr. Phillips just spoke to, namely, the loss of incentive to seek new equity funds in Canada. I had not expected Mr. Bovey to produce such a prize

example as that of his seeking yesterday for a sale of equity shares south of the line, but I would make reference to the last sentence in section 1.42, which is at page 12 of the White Paper, where in discussing the philosophy of tax credit, it is stated:

> It would thus provide a powerful incentive for investment by Canadians in Canadian corporations.

I think we should realize that unless the provinces act to bring about the tax credit in the way I indicated a little earlier then this incentive will be lost.

The Chairman: In the light of what has been said here this morning that statement would not appear to have much substance. If the provisions in the White Paper go through can you then say with any sense of correctness that this would provide a powerful incentive for investment by Canadians in Canadian corporations?

Mr. Hurst: No. I think Mr. Phillips' evidence would indicate that it would be a "disincentive", if I may use that word. It is not consistent with the stated intention.

The second point that we do want to make refers to the Public Utilities Income Tax Transfer Act. We did not want to leave a situation in which the views of our company as to what should be done with this act are not known.

In the first paragraph on page 2 of our brief we make reference to the point discussed by Mr. Harrington earlier, as to whether or not the withholding of 5 per cent would cover the granting of the 20 per cent dividend credit that we have under the existing tax law. It had been my understanding that it did not cover it; that the 5 per cent was too small. But, I think it is interesting to note that the calculations that were made at that time did not take into account the interest factor that Mr. Harrington referred to this morning.

It is also interesting to note that in section 4.65, which is at page 57 of the White Paper and which was read by the chairman, the reference there in the last sentence is that all of these taxes would be turned over to the provinces who could then decide to what extent they should be turned over to the corporation or its shareholders.

In the brief you will note that we have put down four possibilities as to the disposition of transfer payments—this is in the second paragraph on page 2—and they are customers, municipalities, shareholders, or provincial revenues.

In you compare what I have in my brief with what is in the White Paper you will see that the groups listed are not the same. For example, the corporation is listed in the White Paper. I do not put that in my brief because I do not think that is really a possibility. In the discussions that our company had with the Province of Ontario we have put on record that if the Province of Ontario chooses to make moneys available to the corporation they would be turned over in full to the customers. So, we do not envisage the possibility of a corporation as such using this flow in some way for its own purposes.

I think that Mr. Harrington mentioned this morning the fact that the municipalities are the recipients of a portion of the moneys turned over to the Province of Nova Scotia, and this is the case in Ontario. In earlier days they kept all of the 50 per cent that had been turned over, and more recently they are keeping the full 95 per cent.

Senator Connolly (Ottawa West): How does the company turn over any of these transfer payments to the customer? Does somebody obtain a rebate?

The Chairman: It is by means of a credit on the bill.

Mr. Hurst: I understand that Mr. Maybin will be speaking again, and I think he will be able to give you a good answer. Unfortunately, we have never been in the position of trying to work out these figures in Ontario.

I mention in the next paragraph that the intention of the transfer initially was to have it come back to the customer who through the regulatory process is the one who certainly pays the income tax in the first instance. There has already been reference made this morning to the statements made by Mr. Sharp and to the statements of the earlier finance ministers in having these unconditional grants to the provinces in the hope that it would be turned back to the customers. I think it is a matter of concern to our company that the wording in the present White Paper does not repeat what has been said by, I think, all three previous ministers, that it was their hope this would find its way back to the customers. On the third page of the brief which has been presented by our company, it included the recommendation which is really not dissimilar to the intent of the statements of the earlier ministers of finance. They have suggested here that if a system of tax credits is to be introduced of any sort—obviously we are not keen on the particular

method which has been discussed in the White Paper—I think the appropriate philosophy for the Income Tax Transfer Act, is to have the money made available to the province; that is, the sum of money which is available after the federal Government has deducted whatever amount it uses to grant the tax credit to shareholders, together with administration costs which should not be large, but adjusted for any interest on any significant delays that do occur in making such transfer. I have not suggested that the grant be a conditional one, because I do not think that this is a position the federal Government should take in this field, but I would hope that there would be statements of intent, similar to what had been given in the past so that it can be made clear to the provinces what the wishes of the federal Government are in respect to any such transfers.

The Chairman: Are there any questions?

Senator Hays: I have one in regard to what you thought was the intent of the minister. You mentioned that.

Mr. Hurst: Yes, I have copies of House of Commons *Hansard* of June 23, 1966, and I think the intent of the minister was very clearly stated. Mr. Sharp said on page 6824:

> My predecessor, the hon. member for Davenport, did express the expectation, as did Hon. Donald Fleming when in his 1961 budget speech he announced the continuation of the half-sharing arrangements, that the provinces might wish to use the additional revenue for the benefit of the industry and its customers.

These are industry and, of course, customers are both the same. And it continues:

> I also hope that the provinces will use the federal tax transfer for the benefit of the industry and its customers.

Those are Mr. Sharp's statements.

The Chairman: It seems to me, Mr. Hurst, that if it refunded the transfer of tax money and if that transfer was put into its proper perspective the matter of what the rates should be, would still proceed on the basis of cost of operation and a fair return. Then, this rebate would only come in as a credit at the end of your tax bill. It should not be looked at in determining what the operating rates should be. Therefore, it would not participate in any way in the profit of operations. That is the only way in which you can give the real benefit to the customer.

Senator Burchill: The shareholders do not get any benefit.

Senator Hays: It is because one is nationalized and one is not. It depends on whether you want to foster the free enterprise system or nationalize everything.

The Chairman: Senator Burchill's interjection is good, because this puts the thing in the proper perspective. The shareholder of the public utility is the same as the shareholder of any other company, in those circumstances. His company does not get its hands on this money for the purpose of passing it through or any part of it to the shareholders. Therefore, the shareholders should share in the general principle that if he gets a dividend he gets a tax credit. We have divorced the rebate or transfer of funds completely from the company shareholder relationship.

Mr. Hurst: I might mention, in providing a copy of the Utilities' Transfer Act, that I would like to underline really what you have said. On the second page of the attachment in section 3 of the Utilities' Income Tax Transfer Act, it is very clearly stated that if the payment is out of the Consolidated Revenue Fund and its amount determined by the minister is equal to tax payments, it is not the tax as the White Paper said.

The Chairman: Thank you, Mr. Hurst.

We have a group of companies, the Canadian Utilities Limited, Canadian Western Natural Gas Company Limited, Northland Utilities Limited and Northwestern Utilities Limited. They have submitted a brief. We have Mr. Maybin, who is the Chairman and Executive Officer, Mr. MacFadyen, Mr. Phillips and Mr. Burton. Would you present your panel?

Mr. John Maybin (Chairman and Executive Officer): I will introduce our panel. You have already met Mr. Phillips, our Counsel. Sitting next to him is Mr. MacFadyen, Senior Vice-President—Finance and then Mr. Burton, Auditor for our companies and also a gentleman who gives us a great deal of assistance in our various appearances before our public utility commissions when great matters are being established.

I will give a brief description of the companies so that you will understand why we are here. There are four companies which are listed, all of which operate principally in Alberta and which are under common management. They have two classes of service. Two of the companies are entirely natural gas

utilities and together serve better than 80 per cent of the population of Alberta.

The Chairman: Which ones?

Mr. Maybin: Canadian Western Natural Gas Company Limited and Northwestern Utilities Limited. That is the existence of those two companies and why we also subscribe to the Canadian Gas Association brief you have just heard. The Canadian Utilities Limited is an electric utility company which serves fundamentally different areas than the gas companies do, principally the more remote areas, such as the northern areas of Alberta. They also do provide some service in the Yukon Territories where, incidentally, the tax rebate mechanism is also expected to go into operation. The other company, Northland Utilities Limited, is a combination company which provides some electrical service and some natural gas service, but principally in the northern parts of Alberta. It also provides service in the Northwest Territories in some instances. For just a point of interest, in the Northwest Territories the tax rebate system is in operation. The rebates are going back to the consumers.

Senator Isnor: In what form?

Mr. Maybin: As a discount, is the simplest way to describe it. In effect, just to add to what you briefly heard, the tax rebate system is in full evolution in Alberta, and also in existence in the Northwest Territories. It is expected to be in existence in the Yukon.

Mr. Chairman, perhaps I can add just one or two comments on topics that have not been stressed up to this point.

The Chairman: Yes, go ahead.

Mr. Maybin: With respect to the loss in value of shares which has occurred since the White Paper and the problems of financing that result from that and how it might be overcome, the one thing that has not been pointed out, I don't believe, is that one class of shareholder probably has no solution to overcome the problem, and that is the preferred shareholder. You realize that the preferred shareholder has no way of increasing his yield in the future to off-set any loss of tax credit. You will also realize that he is in no position to hope for any capital gain to off-set any income situation that he may have suffered. In other words, the existing preferred shareholders have the worst plight as a result of the loss of tax credit.

The Chairman: How many of these four companies would have preferred shareholders?

Mr. Maybin: They all have preferred shareholders. In total there would be something in the order of 8,000 of them. That was a point not really stressed.

If I may, I should like to point out some of the features of our brief that are slightly different from the briefs of the individual companies that will be before you today.

You will notice that on page 4 of our brief there is a short introduction describing the companies. On page 5 there is reference to the "creditable tax" system, or what you might choose to describe as the integration of corporation and personal taxes, and that really the problem we are talking about today is one of the off-shoots or side effects, or the complications that result from the desire to implement that system. In other words, what I am saying, briefly, is that if we return to the 20 per cent dividend tax credit system rather than the integrated or creditable tax system the problem we are talking about today with respect to utilities would not exist.

We have some comments in our brief which may be of interest to you pointing out other side effects or complications that flow from the creditable tax system or the integration concept, and explaining why we think perhaps it might be better to stay with the existing system, since it, in total, would create fewer complications.

Our comments with respect to the three sections of the White Paper are, I think you will find, entirely consistent with the philosophy you heard expressed already this morning. We go into greater detail, perhaps, on the implementation of the tax rebate system as it flows right through to the consumer, since our group of companies together with Calgary Power are probably the one having the greatest first-hand knowledge of how that does work. I will leave that now and, if you wish, you may ask some questions later about how it is actually applied.

The Chairman: Mr. Maybin, the consumers of your company, those who are your customers, benefit from the transfer of tax, but the company itself and its shareholders get no benefit, except goodwill.

Mr. Maybin: Except perhaps staying in existence because of the competitive situation.

The Chairman: Yet you are being stuck, if I may use that word, with the denial of a tax credit in any dividend that you might earn by using whatever the rate structure is in your costs; and whatever profit you can make, when you pass that on to your shareholders and have paid your taxes and the transfer of funds has been used, has no relationship to your shareholders and your company in that sense; yet you are stuck with the denial of tax credit.

Mr. Maybin: That is correct, sir. It might help to clear the situation if I were to explain that our rates are established by a provincial utility commission which in effect sets the rates on the basis that we are a tax-paying corporation and it builds into those rates the fact that we have to obtain enough revenue to pay taxes along with other costs. The rates are not set in any way related to any tax rebate that may occur. The tax rebate comes after that, you might say. There is provincial legislation which governs it. In essence, you might say that the money which is received by the provincial government is turned over to the corporation for distribution to the consumers on certain stipulated methods of distribution, and, in essence, what happens is that the bills are made out on the basis of the rates which have been set by the Utility Board which are related to the fact that we are a tax-paying corporation, and then the provincial discount, as it is described and must be so by legislation, appears on the bill and this in essence is a discount which, as I mentioned in some previous examples, might be 8 per cent of the bill or might be 8½ per cent or might be 5 per cent, depending on which particular company and which particular service we are talking about. So, in effect, the customers' total cost is reduced by the so-called provincial discount.

The Chairman: The provincial legislation determines the formula that you apply, I suppose?

Mr. Maybin: That is correct, sir. There are regulations which set forth the method which must be used, and they have to be approved by the provincial government before, in effect, the funds are turned over for distribution.

So far as the remainder of our brief is concerned, sir, we mention one or two other points which we think affect the cost to consumers. Perhaps you would rather not have us deal with those today, since they deal with depletion and things of that nature.

The Chairman: I expect you will be back with us again on the question of how the mining industry and depletion in that respect are dealt with. Is that correct?

Mr. Maybin: We did not plan to come back, sir, but if you would rather have us come back to touch on those points, we will. In essence, we are simply saying that we would like the Government to be aware that in respect of some of the changes proposed in the depletion system and the regulations respecting new mines, those changes may have the effect, and probably will have the effect ultimately, of increasing the cost of natural gas and electrical service to the public. This is simply what our brief points out.

The Chairman: In what way would that come about?

Senator Connolly (Ottawa West): What page of your brief is that mentioned on?

Mr. Maybin: Page 18, sir, is one aspect of it, and page 19 is the other. In as few words as I can, I can describe what I mean by saying that the White Paper itself concedes that the changes in this type of thing, that is, depletion and support to mining and oil and gas operators, are designed to give less support to exploration and development than previous rules did. You must realize that a natural gas company buys a very large proportion of its natural gas supplies from producing companies. The majority is bought from producing companies. So to the extent that exploration and development becomes more expensive, ultimately the cost of the gas supply must become more expensive and ultimately it will pass on to the consumer under our regulation-making and rate-setting procedures. The same thing is true with respect to power companies where a loss of depletion allowance or a lessening of the depletion support, a lessening of the exploration and development support, will ultimately lead to higher costs of coal; and, certainly, in the case of our companies, the coal which is used for the thermal generation of power is bought from other companies and, to the extent that costs of mining and developing mines increases, so the cost of electrical service to the consumer will increase ultimately.

We just wish to have any government committee concerned with those rules aware of the fact that this could affect consumer prices.

Senator Connolly (Ottawa West): One of the first witnesses to appear before us on this White Paper was Noranda. Speaking of depletion of mining companies, Noranda told us at that time that changes had been contemplated in the United States law in respect of depletion that had been introduced in one of the houses of the Congress, but there was a change in the other house in respect of certain areas of the mining industry—which, I presume, would include petroleum and natural gas—by means of which the depletion allowances that normally existed were restored. Does that apply to natural gas and petroleum down there, or do you know?

Mr. Maybin: I really could not say for sure, but my understanding is that it did.

Mr. A. G. Burton, C.A.: If I understand your question correctly, the basis of depletion in the United States has been essentially $27\frac{1}{2}$ per cent of gross income, not to exceed 50 per cent of the net. With these recent changes you have mentioned, that rate of $27\frac{1}{2}$ per cent has been reduced to 23 per cent. However, depletion in the United States is completely different from depletion in Canada. In the United States you deplete each property on a separate basis and you take your gross depletion at the time you produce the oil. In Canada our depletion has been on a basis of $33\frac{1}{3}$ per cent, but you must first deduct all your expenses on any properties against all your income, with the result you do not get depletion in Canada until such time as you are paying taxes.

The White Paper has taken one more step and has said that instead of taking a straight percentage of profits you will only get depletion based on the amount of exploration work you do, excluding your cost of acquisition of your property interests, and you are still limited to not more than one third of your taxable income. This means, therefore, in no way can your depletion under the White Paper be greater than it was under the present act, but it will be less as time goes on. To the extent it is less, as Mr. Maybin suggested, the highest single cost for your gas distribution company is the cost of gas and, therefore, if the cost of gas goes up, unquestionably the utility rates will have to go up.

Similarly, in the electric industry, people might wonder why we talk about depletion for electrics, but coal is used, and if you take away the three-year mine exemption and thereby increase the cost of coal, in turn you have an increase in the cost of your electricity.

Senator Connolly (Ottawa West): Could I pursue that one step further? As I understand it, despite the fact there are differences between the American and Canadian systems, in the American system they make a differentiation between different areas of the mining industry. They allow higher rates of depletion in certain sections of the mining industry, and not such high rates of depletion for other sections.

Mr. Burton: When you say "sections," I presume you mean the different types of minerals?

Senator Connolly (Ottawa West): Yes.

Mr. Burton: Yes, there are different rates for different types of minerals.

Senator Connolly (Ottawa West): Yes, petroleum, natural gas—that is quite different; and perhaps in the minerals there are variations too.

Mr. Burton: Yes, petroleum and mining are quite different in the States, and within the mining you get different rates for different minerals.

Senator Connolly (Ottawa West): Would you say that depletion should take into account not only the matter of encouraging the development of the mining operations, but also should take into account the factor that the asset is a wasting asset, so it, in part at least, compensates for the loss of the asset?

Mr. Burton: That is correct, sir, because when you take a barrel of oil out of the ground there is no way you can replace it. You might find another barrel, but you cannot replace it.

Mr. Maybin: That is one point we specifically comment on at page 18 of our brief. Some of you may remember that back prior to 1962 there were some exploration—let us call them—"acquisition costs" for which there was no way you could get a deduction for tax purposes, and the only possible offset there was was the depletion. So, in some ways, in those days depletion was considered as the offset for the type of asset for which you had no other way of obtaining a tax deduction.

We have a number of such assets purchased before 1962, and one which we cite in our brief is the $\$4\frac{1}{2}$ million gas field we purchased which is one of the fundamental

sources of supply to the City of Calgary. In the past there has been no way of obtaining any deduction for that purchase for tax purposes, except through the depletion allowance. I am afraid the changes in the White Paper have the retroactive effect that we will no longer be able to get any deduction for that cost.

The Chairman: Because the new proposals go forward from the effective date?

Mr. Maybin: That is correct.

Senator Connolly (Ottawa West): The rules there are changed after the game has started?

Mr. Maybin: Yes, that is our point, sir.

The Chairman: Are there any other questions? Thank you very much.

Now we have the Newfoundland Light and Power Company Limited. The witnesses are: Mr. D. C. Hunt, Director and Counsel; Mr. C. F. Mallory, Executive Vice-President; and Mr. D. S. Templeton, General Manager.

Would you present your panel, Mr. Hunt?

Mr. D. C. Hunt, Director and Counsel, Newfoundland Light and Power Company Limited: To my immediate right is Mr. C. F. Mallory, and sitting beside him is Mr. D. S. Templeton.

Mr. Chairman and honourable senators, we would like to thank you very much for the opportunity of submitting our brief to you today. There could be no doubt when we heard of this hearing we were given a great deal of reassurance in that we believe the submissions made here today by the various companies appearing are sound, and we know they will receive careful consideration.

Our brief—and I think this is true of the others, except for the last one—has restricted itself specifically to paragraphs 4.63, 4.64 and 4.65. This is because we did not wish to risk diluting our submission by the inclusion of references to any other proposals.

It is vital to us that the paragraphs in question be deleted, and the concern they have caused us has resulted in our focusing all our attention on them.

The brief has been prepared chiefly by Mr. Mallory and Mr. Templeton, and they will be available to answer any questions which might arise. Newfoundland Light is a small utility; it operates in one of the poorer areas of Canada; and we felt that, with your permission, we should read a portion of the brief. I would like to refer you to the second paragraph of the preface, which reads as follows:

The company operates under the jurisdiction of the Public Utilities Act of Newfoundland which is administered by the Board of Commissioners of Public Utilities of Newfoundland. It is the first utility in Eastern Canada to serve urban and rural customers at uniform rates for each classification of service. That these rates are reasonable is indicated by the fact that a family living in a small village in Newfoundland, and using an electric range and electric water heater, now pays less for its electricity than a family using the same amount in any village, town, or city on the eastern seaboard of Canada and the United States.

I would ask you, sir, if you would mind my reading from page 3 of the main submission, starting with the second paragraph.

The Chairman: No, not at all.

Mr. Hunt: It reads:

The authors of the Proposals for Tax Reform apparently regard the taxes paid by utilities as characteristically different from those paid by other corporations. From the tone of the proposals, it would appear that the federal Government considers that the peculiar treatment given to the utility taxes it receives, namely, the subsequent payment from the Consolidated Revenue Fund to the provincial authorities of amounts equal to 95 per cent of the corporation income taxes paid, justifies peculiar treatment of the shareholders who invested their capital in the hope of sharing in the profits which the utility companies might earn. Utility taxes seem to be thought unique in that they are earmarked for return to the provinces; they are not looked upon as being placed in a common pot along with the taxes from other corporations from whence they can be distributed to the provinces in accordance with various federal-provincial fiscal arrangements. Rather, it seems they are considered to be received by the federal Government and paid directly to the appropriate provincial authorities under the Public Utilities Income Tax Transfer Act. But in fact they are paid into the Consolidated Revenue Fund in the same way as the taxes collected from all other corporations. Furthermore, a significant proportion of all the taxes paid into the fund, although not specifically earmarked, are also returned to the provincial governments for such purposes as hospitals, medicare, roads, education and so on, on the authority of acts or orders-in-council. Be-

cause their sources are not identified, all payments to the provinces except those authorized by the Transfer Act, will be ignored in calculating the personal income taxes to be paid by the shareholders. None but the utility shareholders will be penalized. In fact an amount equal to all or most of the corporation taxes paid by all companies in each province goes back to the province. In 1967 the federal Government collected corporation taxes totalling $1,630,000,000 (and in the same year paid the provincial governments and municipalities a total of $1,992,000,000). The corporate income taxes of electric, gas and steam utilities were $40,500,000 in the same year and amount to only 2.5 per cent of all corporate taxes.

It is further submitted that in any event the distinction between the taxes to be paid by utility shareholders and the taxes paid by shareholders of other corporations is not well founded, as it is predicated on a consideration not of the nature or source of the taxes but of their intended use. Utility companies now and doubtless always will be subject to income tax. Why, then, must a utility pay tax in the same manner as other corporations and then be governed by what the payee intends to do with the moneys paid?

The tax treatment of utilities proposed by the federal Government is inequitable in that it leads to double taxation. The Proposals for Tax Reform would render fully taxable in the hands of the utility shareholder earnings on which tax had been paid before distribution. In this respect utility companies and their shareholders would be isolated for special treatment. They alone would be the object of an income tax discrimination.

The securities markets recognized the discrimination immediately after the Proposals for Tax Reform were published. The tabulation below compares the stock prices of a group of telephone utilities which were unaffected by Sections 4.63, 4.64 and 4.65, with those of a sample of electric and gas utilities to which the proposals would apply. The prices are quoted prior to the issuance of the proposals on November 7th and as at November 28th, 1969.

The market statistics clearly indicate that whereas the prices of telephone company shares advanced, those of the electric and gas utilities declined after publication of the new tax proposals. The total market value of electric and gas utility shares relative to telephone utility shares between November 7th, 1969 to January 30th, 1970 as shown in Appendix I fell by nearly $200,000,000. Investment dealers have already advised their clientele on this matter. For example, Bongard Leslie, in its special report on the White Paper of November 17th, 1969, advised investors as follows:

> "Present holders of common and preferred utility stocks such as Newfoundland Light & Power, Nova Scotia Light and Power, Gaz Métropolitain Consumers' Gas, Union Gas, Northern and Central Gas, Great Lakes Power, International Utilities and all of its Alberta subsidiaries, Inland Natural Gas and Calgary Power should give serious consideration to eliminating these commitments from their portfolios."

Then there is a table showing the telephone, electric and gas company share prices.

Senator Connolly (Ottawa West): If the decision to implement the proposals in the White Paper is reversed would you expect that this situation you have described at the top of page 5 to reverse itself?

Mr. Hunt: Yes, we would confidently expect that.

Senator Hays: Have you any shares?

The Chairman: That is a leading question, senator. The witness should take the advice of counsel.

Senator Flynn: I think that Senator Hays is seeking advice.

The Chairman: Then, we will do it privately.

Mr. Hunt:

Newfoundland Light and Power Co. Limited is a growth company. The power requirements of its customers have grown over the past three years at an annual rate of 17 per cent. Its capital expenditures now average approximately $6 million per annum.

The company's capitalization at December 31st, 1968 was made up of a total of $29,462,000 First Mortgage Bonds, $3,954,000 General Mortgage Bonds, $5,714,000 Preferred Stock and $20,679,000 Common Equity. To provide funds for expansion, the company has raised money through the sale of both debt and equity securities. The most recent issues of new securities have been First Mortgage Bonds. In 1966, $5,000,000 Series "R", 20-year, 7 per cent bonds were issued, and in 1968 $3,000,000 Series "S", 20-year 7-3/4 per cent bonds where sold to the public.

In December 1968, the company filed a prospectus for the sale of $3,000,000 of First Mortgage Bonds and although it received the approval of the Ontario and Quebec Securities Commissions, the company felt obliged to withdraw the issue because of unfavourable market conditions. During 1969 the company curtailed its capital programmes but nevertheless added significantly to its bank loans. As at December 30th, 1969, it owed $7,500,000 to its banks. In 1970 the capital expenditure forecast and the requirement to refinance an issue of first mortgage bonds will increase the company's bank loans to $10,500,000, if financing is not carried out before next autumn.

During the past year the condition of the bond market had worsened to the point where the company had given up hope of being able to sell additional long-term first mortgage bonds. In order to finance some of its short-term obligations, it was planning an issue of debentures with warrants to purchase common stock at a specified price. While the company is well known in the Atlantic area where over half of its common shares are held, it is not as well known in Ontario and Western Canada. In order to provide Ontario and western investors with better market accessibility and information with respect to its common stock, Newfoundland Light and Power Co. Limited listed its common shares on the Toronto Stock Exchange in November 1969 as a necessary step prior to offering debt securities with the common share purchase warrants attached. This whole effort has been nullified, however, by the effect of the Proposals for Tax Reform and the company has a serious and immediate problem with respect to long-term financing.

Taxes Paid by Newfoundland Light and its Shareholders

Corporation tax paid by Newfoundland Light and Power Co. Limited in 1969 amounted to $1,742,580. Of this amount about $432,000 is collected by the federal Government on behalf of the Province of Newfoundland and promptly returned to the province. In addition, under the terms of the Public Utilities Income Tax Transfer Act, the federal Government will pay approximately $1,150,000 to the Province of Newfoundland in 1972. Taking into account the provisions contained in the Proposals for Tax Reform, the payment to the Province of Newfoundland would rise to about $1,750,000 because utility taxes would be increased and the amount to be paid would be 100 per cent of the tax collected from the company.

In addition, based on 1969 figures and on the proposed absence of any dividend tax credits, the federal Government would collect from tax on shareholders of Newfoundland Light and Power Co. Limited an estimated $617,000. If the company's shareholders were treated like those of all widely held corporations, the shareholder taxes would amount to an estimated $154,000, or about one-quarter of what is proposed. It is not surprising, therefore, that the shares of Newfoundland Light and Power Co. Limited and other electric and gas utilities are now viewed with disinterest by the prospective investor. It is also worthy of note that 73 per cent of the shareholders of Newfoundland Light and Power Co. Limited common stock live in the Atlantic Provinces, that their average holding is only 450 shares, and that together they own 59 per cent of the outstanding common stock. Less than one percent of the common shares are held outside of Canada. The White Paper plan deals harshly with small shareholders of limited means. If such a shareholder owns 200 shares in the Power Company and has a marginal tax rate of 30 per cent he will pay a tax of $30 on his $100 of dividends, whereas if the shares were those of a telephone company, he would receive a net tax refund of $5 for the same investment. On the other hand, taxes on dividends received by non-residents will be unaffected by the provisions of sections 4.63—4.65.

The Honourable Mr. Benson, Minister of Finance, speaking on a motion to refer the Proposals for Tax Reform to the House of Commons Standing Committee on Finance, Trade and Economic Affairs, announced that the Government was prepared to make a modification concerning dividends passing from an electric, gas or steam utility corporation to its parent company. Although the Government thus appears to be prepared to assist the large corporate shareholder (the parent of a utility company), nothing has been done to alleviate the critical burden which would be placed on the shoulders of smaller shareholders.

The Honourable Mr. Benson, after speaking to the Board of Trade in St. John's on January 26th, 1970 and in answer to questions raised by company officials attending the meeting, contended that the federal Government, because of the transfer of funds to the provinces, would be subsidizing the shareholders of the utilities if it allowed them tax credits. Analysis of the disposition of the

income taxes of Newfoundland Light and Power Co. Limited and its shareholders as shown in Appendix II does not support his allegation. On the contrary, it indicates that based on 1969 tax payments, continued distribution of taxes in pre-White Paper proportions, and taking into account the benefit from the use of the tax payments retained by the federal Government for three years prior to transfer to the provinces, the federal Government would benefit by approximately $93,000 if it cancelled the plan proposed in paragraphs 4.63—4.65. The fact that the federal Government does come out about even indicates that the 95 per cent stated in the Public Utilities Income Tax Transfer Act is reasonable. With this being the case, it is respectfully submitted that the utility shareholders could be treated in the same way as shareholders of other widely-held corporations without cost to the federal Government, and that the Income Tax Transfer Act should remain in force and unchanged.

Alternative courses of Action Open to Newfoundland Light & Power Co. Limited.

It is suggested in the Proposals for Tax Reform that the utilities negotiate with the provinces on the matter of their turning over to the corporation or its shareholders some portion of the corporation taxes passed on to each province. There appears to be no way that a practical procedure could be worked out which would be uniform throughout Canada and which would succeed from the economic viewpoint of the company or its shareholders. The provinces presently receiving utility income tax payments from the federal Government have committed the funds for other provincial purppses, in some cases returning the rebate to the utility customers or to the municipalities in which the revenue originated, but not to shareholders. In the case of Newfoundland Light & Power Co. Limited and the Province of Newfoundland, there has been no agreement to return part or all of the utility income taxes to either the customers, the company or the shareholders. Newfoundland has already committed these funds for other provincial purposes.

If the utilities are unable to convince the federal Government to remove paragraphs 4 63 through 4.65 from the Proposals for Tax Reform, which would be an equitable and practical solution, the only recourse that Newfoundland Light will have will be to apply to the Public Utilities Board of Newfoundland for an increase in consumers' rates. If the company is to attract capital in today's markets and in the context of the additional burden which the Government proposes to impose, it must increase its earnings substantially and pay out larger dividends to its shareholders. If the utility shareholder is to pay taxes on his dividends in the same way that he pays taxes on bond interest, the company will have to increase his dividends so that his after tax income will be equal to that which he would have obtained had utility shareholders been treated the same as shareholders of all other widely-held corporations. Using 1969 data it is estimated that the price of electricity to over three-quarters of the people of Newfoundland would have to be increased so as to bring in an estimated additional $1,544,000 of revenue. It is interesting, as shown in the analysis in Appendix III, that the entire amount of the additional revenue ends up in the Government's hands, $772,000 through the payment of more corporation tax and $772,000 through the payment of additional taxes by shareholders. No additional funds arising out of the rate increase would remain with the corporation or its tax-paying shareholders.

Such an increase in earnings and dividend payments would in turn provide an incentive for purchase of the company's shares by foreigners who are unaffected by the loss of dividend credits applicable to resident shareholders. Thus the stage would be set for the takeover of another Canadian company by foreign interests, a company in which there is currently only about one per cent foreign ownership.

The ownership of utilities in Canada varies from province to province. There are provincially-owned, municipally-owned and investor-owned electric and gas utilities. The Public Utilities Income Tax Transfer Act has proven equitable and successful in that it returns the income taxes of the investor-owned utilities to the provinces in which these taxes are collected and thus gives the provinces control of all revenues and the income taxes of their utilities regardless of ownership. In Newfoundland, the Newfoundland and Labrador Power Commission generates electricity and sells it wholesale, but electricity is distributed to the public principally by Newfoundland Light & Power. The 1966 report of the Newfoundland Royal Commission on Electrical Energy recommended that both provincially-owned and private enterprise continue their utility businesses in Newfoundland. The Royal Commission reported that the Transfer Act removed any

incentive for the province to take over the privately-owned utilities then existing. Since that time the several privately-owned small electric utilities, with the approval of the Newfoundland Government, amalgamated into the Newfoundland Light & Power Co. Limited. It is unfortunate that if the Proposals for Tax Reform become law, this new enterprise, its shareholders and consumers will be damaged.

In conclusion, it is the recommendation of this submission that the equitable and practical solution to this dilemma is the removal of paragraphs 4.63 through 4.65 from the Proposals for Tax Reform. Their elimination would not detract in any way from either the basic principles or the procedures proposed by the White Paper.

Senator Connolly (Ottawa West): I take it that your company sells three times as much electricity as publicly owned utility companies?

Mr. Hunt: Probably the General Manager could answer that.

Mr. D. S. Templeton, General Manager, Newfoundland Light & Power Company Limited: We sell about a billion kilowatt hours a year. What was the question again, sir?

Senator Connolly (Ottawa West): I take it that your company sells about three times as much as the publicly owned utilities?

Mr. Templeton: Yes, in more recent years. They will catch up to us probably next year.

Senator Laird: How many shareholders do you have altogether, preferred and common?

Mr. C. F. Mallory, Executive Vice-President, Newfoundland Light & Power Company Limited: I think there are about 6,000 or 7,000, sir. We do not have an exact figure, but I can get it for you.

Senator Laird: Of an orphan type, or do you know?

Mr. Mallory: The outline we had back here in the text fairly well substantiates that. Most of them are in the Atlantic area and we do not have any real large shareholders in our company a all.

Senator Beaubien: How does your stock fare? What is its all-time high and what is it selling at? What does it pay?

Mr. Mallory: There is a bit of history behind the price of the stock. In 1966 Newfoundland Light and Power was really a new company, formed by the amalgamation of several companies. Since its listing on the Montreal Exchange in 1966, the highest price has been in the order of $12. It is now selling at about $7.

Senator Beaubien: What dividend do you pay?

Mr. Mallory: Fifty cents a share. Our earnings are about $1.

Senator Flynn: If the result of these proposals is, as you mentioned, Mr. Hunt, an increase in the rates making the buying of the shares more attractive for foreigners, would you conclude that this would be an incitement for the government of Newfoundland to provincialize your company?

Mr. Hunt: It could. In partial answer to that, sir, if I could file a letter which was prepared by the Board of Commissioners of Public Utilities as an exhibit for the hearing, I might say that we are very fortunate in Newfoundland to have a public utilities board which has gained the complete respect of the public and the industry. They have reported to the government, made an independent survey, used independent auditors and they state that the proposal will mean that the electrical utilities will be provided with grounds for application to their regulatory authority to obtain increases in the rates which they charge customers in order to attract investment in shares of these companies. So that is their view also. May I file that, sir?

The Chairman: Yes, but Senator Flynn's question was to the effect that if you were faced with that situation now, would you expect that your company might be provincialized?

Mr. Hunt: We don't know, sir. It would certainly give the province of Newfoundland a reason to take over the assets of the company, which would of course be from funds which would otherwise be used for other public services that are badly needed.

Senator Connolly (Ottawa West): In other words, the report of the Royal Commission in Newfoundland in 1966, which at the end of your brief you say reported that the Transfer Act removed any incentive of the province to take over the privately-owned utilities existing—that recommendation would probably be changed, or could be changed, in the light of

proposals in the White Paper, if they were implemented.

Mr. Hunt: Could be, yes, sir.

Senator Flynn: And there would be a loss federally, if the Treasury were stopped from collecting funds on dividends of corporations.

The Chairman: That is right. There would be a loss of revenue to the federal authority.

Senator Burchill: On page 5 of the brief there is a comparison between the trends of the stock market between telephone companies and electrical and gas utilities. In that legislation for transfer payments of 1966 were telephone companies not included?

The Chairman: No.

Senator Burchill: They were not?

The Chairman: No. It was just electrical, steam and gas. As a matter of fact, I can tell you that there was quite a discussion in 1966, and at an earlier period, whether the telephone companies should be included, and there was quite a debate in the Senate in which I think you took part.

Senator Connolly (Ottawa West): Section 2 of the act, as filed with the Consumers' Gas brief, talks about a designated corporation and it includes a company for the distribution and sale of electrical energy or steam or the distribution and sale of gas to the public in Canada.

The Chairman: Yes. Are there any other questions?

Senator Hays: I have a suggestion. I think Mr. Mallory should move to Alberta.

Senator Beaubien: And take the company with him?

Senator Flynn: He could even move to the United States.

The Chairman: Yes, the United States is much closer. Thank you very much.

Mr. Hunt: Thank you. If we may, we would file some changes which arose recently in the figures.

The Chairman: We could incorporate them in our report.

Mr. Mallory: I would just like to refer you to appendix 2, in which we made the calculation of the difference in cost arising out of the White Paper proposals, if the Public Utilities Income Tax Transfer Act were continued as is, and if our shareholders were treated the same way as widely-held corporation shareholders.

The Chairman: Yes?

Mr. Mallory: At the time we made these estimates we made an error, as did the witnesses from Nova Scotia Light and Power, in determining the federal share. But in view of Mr. Gilmour's work, which was given in No. 8 transcript of your committee, we revised our numbers; the $93,000 appearing there should be $54,000. We will submit a new sheet giving those figures in detail for your transcript.

The Chairman: Thank you.

Mr. Mallory: I should like to add also, sir, that we have done a similar calculation for all of the utilities in Canada and we should like to file that. It shows that the federal Government would still benefit by $3.3 million. It is done on the same basis as this calculation and we should like you to have that as part of the record as well, sir. Thank you.

The Chairman: That will be incorporated in the record today.

We have one more submission, honourable senators. The Maritime Electric Company is here today with Mr. A. H. Peake, Director and Counsel, Mr. A. D. Cameron, Vice President and Mr. R. W. Smith, General Manager.

Mr. A. H. Peake, Director and Counsel, Maritime Electric Company: Mr. Chairman, honourable senators, we thank you sincerely for the opportunity of being here today. We are the last to appear today, but we hope we are not the least.

In presenting this brief as a counsel and director of the Maritime Electric Company living in Prince Edward Island, I thought it would be helpful and informative to review briefly the development of our power facilities in Prince Edward Island over the past years. Prior to and during World War II only the urban centres of the province together with a few rural areas were supplied with electricity. At one time there were 16 small utility companies in operation in the province; a very minor percentage of the farms had power available, and most of those were adjacent to the urban centres.

Today 90 per cent of the occupied farms and settled areas of the province have electri-

cal service. This was achieved by the co-operative effort of the provincial government, the farmers and our company, under the Rural Electrification Plan, whereby the company provided the funds to finance the generation, the substations, the transmission and main distribution lines; the province provided the funds for the construction of the rural branch lines, and the farmer financed the line leading from the road over the farm to the farm buildings.

At the present time our company supplies all the power in the province with the exception of the town of Summerside and the area in the immediate vicinity of Summerside, which is partially supplied by the town generating plant.

Senator Connolly (Ottawa West): This is all thermal, is it?

Mr. Peake: Right, sir. By an interchange agreement the company supplies Summerside with the power required beyond the capacity of their plant and present indications are that future increases in demand by the town and the people served by the town will be supplied by the company because the town is not going to increase its generating facilities. So, in effect, the company has therefore the important responsibility of providing all the future power requirements of the province.

On March 7, 1969 an agreement establishing a development plan for Prince Edward Island was executed between the federal Government and the province. It is a 15-year plan divided into two phases—Phase I running for a period of five to seven years, and Phase II for a period of six to eight years. This is proposed to be completed over the 15-year period, though the relative period of each phase might be altered. It deals with every area of the economic and social life of the people. In the economic area the basic industries of farming, fishing and tourism are to undergo major developments.

First, to deal with farming, 93,000 acres of poor agricultural land are to be reallocated to tourist, forestry and wild-life use. 270,000 acres of presently unused good agricultural land are to be added to the 550,000 acres presently being farmed. New areas of farming endeavour are to be encouraged. For example, tobacco farming, which is in its infancy in the province, is progressing every year. In order to reduce the overhead of farmers who wish to diversify their farming and grow some tobacco, the possibility of establishing processing centres to provide greenhouses for young plants, cultivating and spraying machinery, kilns, storage and curing facilities for the crops in different areas of the province suitable for tobacco growing are being investigated. These would be centres established in good tobacco-growing areas in the province, and would enable greater participation in the field of agriculture, should it develop.

With regard to fishing, there are two areas, the inshore and the offshore fishing. A concentration of inshore fishing port facilities is proposed. Eight years ago there were 84 such ports in use. These are mostly the ones that will bring in lobster and some few groundfish. As I say, there were 84 eight years ago; today there are 73. Under the plan 14 to 20 ports will be developed adjacent to the best fishing areas to provide the following facilities: storage capacity for bait; holding facilities for the catch; and skidways to effect easy repairs on the boats. These ports will have to be fully serviced with water, power, waste disposal and housing. The other ports the federal Government is going to continue to maintain up to safety standards, if they wish to use them, but people are being encouraged to concentrate in those ports in the best fishing areas and to make the inshore fishing industry more efficient.

Offshore fishing will operate out of the ports of Souris and Georgetown. The plants located in these areas—two in Souris and one in Georgetown—are to be increased in capacity and provided with addititonal freezing, holding and processing facilities.

With regard to the third area, that of tourism, three main tourist complexes are to be developed: in the eastern end of the province at Brudenell; in the centre of the province at the national park at Cavendish and Stanhope; and in the western part in the Mill River area. Each will have golf courses, some of which have already been constructed, motel and dining facilities, bathing, deep-sea fishing and other areas of attraction for the tourist.

These power demands in these three areas of economic development will be substantial, and the company must be prepared to provide the power needs when and where required.

Other areas of development include education, adult education, vocational training, housing, transportation, industrial waste disposal and water supply, manufacturing and processing, health and welfare, and market development.

These too will have substantial power requirements.

If the objectives of the whole development plan are to be achieved and met on schedule, it is essential that the company which has been charged with meeting with the increased requirements of industry and the public for electric service, be able to raise the capital necessary for the provision of generators, power lines and other equipment.

Gentlemen, coming from a farming province, I will use the term that I do not propose to plough ground that has already been well ploughed by our friends from Nova Scotia and Newfoundland, so I do not propose to read the brief. However, I would like to read the summary which appears on the first page:

> This submission is made on behalf of Maritime Electric Company, Limited and its electricity customers in Prince Edward Island. It is concerned with the effect of paragraphs 4.63 to 4.65 of the Government's White Paper on Tax Reform, which would deny dividend tax credits to the shareholders of certain public utilities on the grounds that the federal Government proposes to transfer to the provinces amounts equal to the corporation taxes paid by these utilities.
>
> The announcement of these provisions of the White Paper has already increased the cost of capital to the investor-owned electric and gas utilities and affected their ability to raise adequate amounts of money for the expansion of their systems to meet their customers' needs. In Prince Edward Island this means a possible increase in the price of electricity, in the face of a need to hold the price at the lowest possible level, and inhibition of expansion of electrical services, in the face of a need to expand the economic base of the province.
>
> The expectation of what amounts to double taxation of the shareholders of these public utilities has led to a drop in the share values of the utilities affected, relative to share values in other industries, of over 200 million dollars. The majority of the shareholders of Maritime Electric live in the Atlantic provinces and have relatively small holdings of shares.
>
> This submission contends that the federal Government's disposition of moneys to the provincial governments should have no bearing on the administration of tax collection. It presents estimates to show that the provisions contained in paragraph 4.63 to 4.65 can be deleted from the White Paper without cost to the federal Government.

In conclusion, I would say that our provincial crest bears on it the words "*Parva Sub Ingenti*"—"Small Under the Great." Under the development plan it is to be hoped that our problems will become smaller and our province greater.

Consequently, it is submitted that the Federal Government could extend to the shareholders of electric and gas utilities the same credits on income tax on dividends as proposed for the shareholders of other widely-held companies without cost to itself and that the Public Utilities Income Tax Transfer Act should be continued in its present form.

Mr. Cameron and Mr. Smith are available to assist in answering any questions.

The Chairman: Are there any questions? We have pretty well covered the subject matter, and I do not think there are any questions that we need to ask you at this time.

Mr. A. D. Cameron, Vice President, Maritime Electric Company: May I be allowed to draw the attention of the committee to some amendments that need to be made to pages 9, 11 and 12 of the submission. These are caused by our making calculations similar to the ones made in previous submissions.

On page 9, the figure of $43,000 in the last line of the second to last paragraph should be $33,000.

On page 11, the figure of $105,000 in the second line of the second table should be $114,000. In the last line of the second table, the "Revenue assuming classification as widely held corporation", should be $25,000 instead of $26,000.

On page 12 the final figure of "Gain in Federal benefits through application of Method II", should be $32,700 instead of $42,700.

The Chairman: Would you write to us confirming that?

Mr. Cameron: Yes, sir.

The Chairman: When we receive your confirmation we will distribute another sheet containing this information.

Mr. Cameron: Thank you, sir.

Mr. Peake: We have made our submission briefly, but I should like the committee to take a few extra minutes in which to hear Mr. A. W. Howard, who represents the gas and electric industry.

The Chairman: Yes.

Mr. A. W. Howard, President, Calgary Power Ltd.: Mr. Chairman, and honourable senators, I will take up but just a few minutes of your time. I am the chairman of a small informal committee which drafted a brief on behalf of some 25 investor-owned electric and gas utilities in Canada. The companies that have appeared today have all subscribed to it. Unfortunately, because of the shortness of time and the unavailability of some people it is not possible for us to make a presentation today, but needless to say the brief supports entirely the views already expressed in respect of sections 4.63, 4.64 and 4.65 of the White Paper.

My point, therefore, is to draw the attention of the committee to the fact that this brief does exist. It has been filed with the secretary. Unfortunately, we are unable to appear at this time, but we shall appear on some subsequent day.

May I also draw your attention . .

The Chairman: What do you wish us to do? Are you saying that you will make an appearance at a later date?

Mr. Howard: Yes, I hope so.

May I also draw attention to another brief pertaining to the problem which has been prepared by a group of security underwriters in Canada, and which points out the financial implications of these proposals in the White Paper. I believe that brief has also been filed.

The Chairman: Thank you. This concludes this phase of our sitting. We have a few minutes left, during which Mr. Gilmour might introduce a short but very cogent statement on the position of small businesses that he has prepared. If the committee agrees, then I think it is important that we get something in relation to small businesses on the record at this time.

Senator Lang: I should like to ask Mr. Gilmour a question. What would be the effect if, rather than following these proposals, the Government made these utilities tax exempt corporations?

Mr. Gilmour: I do not think it would have any real effect, senator.

Senator Flynn: It would not have any effect unless the provincial government took them over.

Mr. Gilmour: Yes. The briefs that we have heard this morning have said essentially that the White Paper proposes to remove the present 20 per cent Canadian dividend credit. There is one thing that is not clear to me in this White Paper, and that is whether there would still be a grossing-up of dividends paid by public utilities. If that be the case then there would be a double-barrelled kick in the stern to the shareholders of public utilities. Common sense tells me that that will not apply, but I have not found too much common sense in the White Paper. So, if the utilities were declared to be tax exempt for federal and provincial purposes there would still remain the question: What happens to the dividends paid to the shareholders?

The Chairman: Mr. Gilmour, if the income of public utilities was tax exempt, then the dividends that those utilities would pay would be entitled to no tax credit.

Mr. Gilmour: Subject to the decisions of the provincial regulatory committees, Mr. Chairman. I cannot conceive that there would be a doubling-up...

Senator Flynn: The province would have to make up that loss somewhere.

The Chairman: Yes, the province would tax.

Senator Connolly (Ottawa West): Mr. Chairman, I did not quite understand what you said in your last remark.

The Chairman: I said that if the dividends were paid out of tax exempt income then there would be no tax credits.

Senator Lang: But they would be bigger, I presume.

Mr. Gilmour: Senator Connolly, even if the companies were tax exempt I fee that the provincial regulatory bodies would be very interested in restricting the earnings of such company. In other words, I cannot conceive of the earnings of such a company being suddenly doubled and available for distribution.

The Chairman: I think you are right. I think that the rate regulating bodies would move in, and also the province would move in.

Senator Flynn: And that would create discrimination to the extent that preferred treatment for these companies would not be justified.

The Chairman: That is right. Mr. Gilmour, would you like to proceed?

Mr. Gilmour: Gentlemen, I have prepared, in case any of you suffer from insomnia, some more study papers.

Senator Connolly (Ottawa West): They are stimulants.

Mr. Gilmour: At the last meeting I introduced Study No. 4 which deals with the very vital point of the grossing-up of Canadian dividends. This is one of the major items in the White Paper, and at the last meeting I submitted to you a quotation from the British Chancellor of the Exchequer which was to the effect that Great Britain has thrown away the proposal that is now recommended for adoption by Canada.

I have continued that study because, being essentially a bookkeeper by trade, I like to know what all these high-falluting phrases in the White Paper mean when you start to apply them to a practical case. My purpose in Study No. 4, which is now completed, is to indicate the serious tax effects that the adoption of the grossing-up or the integration of corporate and personal taxes will have upon the small businessman. The White Paper seems to take a kick at the small businessman on every possible occasion, and for those of you who have the time you may find some interesting reading in Study No. 4.

Now, Study No. 5...

Senator Connolly (Ottawa West): Before you leave Study No. 4 there may be some questions that we want to ask you. I certainly have some in respect of Chapter 3, if only to ask what the table at the bottom actually means. This may not be the occasion on which to do that, Mr. Chairman, and perhaps it can be done on another occasion.

However, it seems to me that the only people who have been complaining to us about the problem of the small businessman have been the big businessmen. I am wondering whether we can expect to receive any submissions from small business.

Mr. Gilmour: We have been trying desperately to get a submission from the small businessman, but to date we have not succeeded. I will guarantee that eventually we can within the next six weeks.

The Chairman: Mr. Gilmour, I might add that we have had substantial correspondence. There were two days a week ago when the accumulation reached the order of 150 letters. Our Executive Secretary is analyzing every letter that comes in. These letters are from people who are stating their position and criticisms, but they are not asking to appear. We are breaking down those letters under subject matter and therefore we will be able to tell you about the number of letters which we have received and how many raised the point of small business. My recollection is that in a substantial number of these letters the point is raised about small business and how small business is treated.

Senator Connolly (Ottawa West): By small business?

The Chairman: Yes.

Senator Connolly (Ottawa West): They may not be organized and I suppose this is one of the problems.

The Chairman: They write sensible letters and these will form part of our record. In order to make your point known, it does not necessarily mean that you have to come here and present a brief. These letters will be considered and noted as to what they have to say. Some of them will be read into the record at the appropriate time.

Senator Laird: Mr. Chairman, do you want us to pass on to you letters which we receive? I have received dozens of them from small businesses.

The Chairman: We can break them down. We may have duplicates, but otherwise, yes, we would like to have them, because we have the facilities for cataloguing.

Senator Hays: Do we have anywhere in the studies which you have given us, or is it possible to get one, a breakdown of small businesses, such as those incorporated and those not incorporated?

Mr. Gilmour: I am not sure that we have the statistics available, Senator Hays. We had great difficulty obtaining any statistics at all about incorporated companies, but through the courtesy of the Minister of Finance, a short time ago we did receive a breakdown of corporations. It produced, in my opinion, some most remarkable statistics. There was passed out to you a few minutes ago a sheet that I prepared last evening, which deals with the breakdown of corporations. I would ask, if you would be kind enough, in due course to put that schedule at the back of Study No. 5.

Senator Hays: Before you leave this, is there any place that information is available? Can a dentist or other professional people incorporate? There is a great discrimination between those incorporated and those who are not incorporated under the present tax structure.

The Chairman: Those unincorporated will be at their individual rates.

Senator Hays: They are on a different rate.

The Chairman: Completely.

Senator Hays: With great respect, Mr. Chairman, it is good for lawyers. Some people may not want to incorporate.

Senator Connolly (Ottawa West): I do not know that the lawyers need to be singled out—not that I have any special brief for them. If you have an unincorporated organization that is manufacturing something, what we are talking about here, I should think, is corporate taxes. In that case, it seems to me that the tax is a personal tax. Whatever the profit is they pay at the personal rates.

Senator Hays: This is true, but you remember when Mr. Bryce was here he said there was a great unfairness between those that were incorporated, doing exactly the same as the ones that were not incorporated. I was wondering if there are any statistics as to the number which are not incorporated?

Mr. Gilmour: To my knowledge, no. I will take a look at the published taxation statistics. They do give breakdowns, such as taxpayers and income by professions. Primarily, it is the professional man who cannot incorporate. I will see what figures are available. I have spoken to the Chief Statistician of the Taxation Division, who assures me that the only statistics their computers are capable of producing are those that are published, although these were not published up until a day or two ago.

I would like to draw your attention to the schedule that came out showing the extraordinary number of small incorporated companies. According to the statistics furnished by the Minister of Finance, there are 92,279 companies in Canada that pay tax. According to the White Paper there are somewhat over 200,000 companies that file income tax returns, whether or not they are taxable. Therefore, roughly one-half are non-taxable and one-half are taxable. Now, looking at the statistics furnished, you find the remarkable thing that we have 18,612 corporations whose taxable income is less than $2,000. We had 81,366 corporations whose taxable income was less than $35,000. Then we have the very small number of 10,913 corporations whose taxable income exceeded $35,000.

One of the basic proposals of the White Paper, in order to achieve this so-called harmony between corporate taxes and the shareholders' tax, is that every corporation, no matter what its size or its industry, must be required to pay a corporate tax of at least 50 per cent. Perhaps some day that will be the maximum tax, but it involves sweeping away the present tax rate which is a tax of about 21 per cent on the first $35,000 of taxable income and that applies today to all corporations regardless of their size. You have two rates of tax. It is a simple graduation. If the White Paper proposals go through and the lower rate of tax on the first $35,000 is eliminated, then we have the remarkable fact that the companies whose income is less than $35,000, which normally would be the small business, will pay $214 million, whereas the large corporations whose taxable income is over $35,000 will pay $61 million. According to the publicity which has surrounded the White Paper this is a "soak the rich" program, yet the arithmetic resulting from a sharp pencil does not seem to indicate that.

Gentlemen, I have imposed on your time beyond the adjournment. I suggest that these may form interesting reading.

The Chairman: Well, there is nothing like a sharp pencil to disprove something.

Senator Connolly (Ottawa West): It is not "soak the rich"; it is "sock the small".

The Chairman: Is there any particular question you have to ask Mr. Gilmour?

Senator Lang: It is not a question, but rather a statement: All the talk we hear about the White Paper is that those who can afford to incorporate as opposed to those, presumably, who cannot, should not receive preferential treatment. As a lawyer I think that business of affording to incorporate is highly exaggerated. It generally costs about $500 for small businesses.

Senator Hays: Then there are the auditors' fees.

Mr. Gilmour: In study No. 4, which we have not yet discussed...

The Chairman: We may deal with it on March 18.

Mr. Gilmour: ... there are some pretty appalling implications on the existing surplus accumulations of both the small, closely held corporation and, of course, the public corporation. All through this White Paper proposal there is in my opinion the deliberate intent that we will single out existing surpluses for taxes that approach confiscation. We are, in other words, taking a serious kick at all corporations, but we are particularly doing so at the closely held corporation that has accumulated surplus up to the end of 1970, when possibly the new proposals may become law. The inference is pretty obvious. It is not my place to hand out tax advice of this nature, but the inference is very obvious. If I were a shareholder of a closely held corporation, which I am not, I would certainly bail my surplus out today and not wait for the...

The Chairman: Not wait for the axe.

Mr. Gilmour: Yes.

Senator Hays: There are about 75,000 farmers in this country paying income tax. You might find out what number of these are incorporated. They are all small businessmen.

Mr. Gilmour: I will try.

The committee adjourned.

APPENDIX A

NOVA SCOTIA LIGHT AND POWER COMPANY, LIMITED

SUBMISSION

TO

THE SENATE COMMITTEE

ON

BANKING, TRADE AND COMMERCE

CONCERNING

DIVIDEND TAX CREDITS TO SHAREHOLDERS OF

INVESTOR-OWNED ELECTRIC UTILITIES

NOVA SCOTIA LIGHT AND POWER COMPANY, LIMITED

SUMMARY

1. Nova Scotia Light and Power Company, Limited is an investor-owned electric utility with approximately 9,350 common shareholders (93% of whom own 1,000 shares or less) and approximately 4,400 preference shareholders (70% of whom have a capital investment, calculated on the basis of par values, of $2,000 or less). Over 95% of the shares of the Company are owned by Canadian residents and over 70% are owned by Nova Scotians.

2. The Company serves approximately 120,000 customers most of whom are in the Halifax-Dartmouth metropolitan area. This region has been designated by the Province of Nova Scotia as a growth area and comes within the scope of the Regional Development Incentives Act of Canada. Accordingly, the Company must gear its expansion to meet not only the normal increase in public demand for electricity but also to meet the demands of industries which locate in this area as the result of the regional economic expansion policies of the Federal and Provincial Governments.

3. The Company pays income taxes to Canada in the same way as any other taxpaying Canadian corporation.

4. In 1968 Canada collected income taxes of approximately $2,620,000 from the Company. Ninety-five percent of Canada's share of income taxes on the electric utility income of the Company will be rebated to Nova Scotia under the Public Utilities

Income Tax Transfer Act. The White Paper suggests that this rebate be increased to 100%. The purpose of the Act was to effect neutrality between the taxpaying investor-owned utility and the tax exempt provincial government owned utility.

5. Neither the Company, its shareholders nor its customers are entitled to receive any portion of the Company's income taxes returned to the Province.

6. For the purpose of taxing shareholders on dividends received from the Company the White Paper proposes in paragraphs 4.63, 4.64 and 4.65 that the Company be considered as having paid no taxes at all. In so doing it denies electric, gas and steam utility shareholders the dividend tax credit available to the shareholders of all other taxpaying Canadian Corporations.

7. This highly discriminatory tax treatment is proposed because of Canada's rebate to the Provinces of 95% of the income taxes collected from these utilities. This confuses tax gathering with tax spending. It ignores the following:

(a) the Company does not control the amount of taxes it pays to Canada;

(b) it does not control the fiscal relations between the Federal and Provincial Governments;

(c) it does not control the manner in which its tax dollars are spent or transferred;

(d) neither the Company, its shareholders nor its customers receive any part of the income tax transferred from Canada to Nova Scotia;

(e) Canada has the use of these income taxes for three years.

8. The Company pays taxes as do other Canadian Corporations. Its shareholders should not be treated differently from those of other corporations merely because Canada and Nova Scotia have earmarked the bulk of the Company's tax dollars for rebate to Nova Scotia.

9. This proposed discriminatory treatment, if it were adopted by Parliament, would:

(a) seriously impair the ability of the Company to raise capital to finance expansion;

(b) place electricity at a competitive disadvantage vis-a-vis competing fuels;

(c) deny the investor the dividend tax credit available to shareholders of other corporations;

(d) require the Company's customers to pay more, and perhaps substantially more, for their electricity; and

(e) destroy the tax neutrality between the taxpaying investor-owned utility and the tax exempt provincial government owned utility which was effected by the Public Utilities Income Tax Transfer Act thereby completely negating the underlying principle of the Act.

10. The only fair and equitable way of dealing with the problem is to recommend against the implementation of paragraphs 4.63, 4.64 and 4.65 in their entirety.

COMPANY SHAREHOLDERS

The White Paper aims at partial integration of the taxation of widely held corporations and their shareholders. It is proposed that this be achieved by giving Canadian shareholders credit for one-half of the tax paid by a corporation on the profits from which the dividend is paid.

The White Paper proposals deny this tax credit to shareholders of gas, steam and electric utilities.

The table appearing as Schedule A compares the tax position of shareholders of electric utilities and other widely held corporations with marginal tax rates of 30% and 50% respectively both under the present Income Tax Act and under the White Paper proposals.

From this Schedule it will be seen that shareholders of other widely held corporations will retain out of every dividend dollar (after the payment of taxes) 50% more than the shareholders of electric utilities.

This result will clearly depress the market price of electric utility shares, thus stripping from existing shareholders much of the value of their shares. Since the publication of the White Paper this has already happened to a marked degree. It is contended, however, that the market has not fully reflected the effect of the proposals because utility investors are not prepared to believe that Parliament will discriminate against them in this way.

While the Minister of Finance has stated that the White Paper is only a proposal for tax reform which will be

modified after public discussion, the fact that these proposals have been made has depressed the market for the Company's shares. As will be pointed out later in this submission, this has already impaired the ability of the Company to raise capital. Thus the proposals themselves have created problems for the Company at this time even though these proposals may never be implemented. This is evident from the market performance during the past several months as illustrated on Schedule B.

If the Committee is prepared to recommend that proposals 4.63, 4.64 and 4.65 be rejected, it is important to the Company that an announcement to this effect be made forthwith so that the Company may regain the confidence of the investing public in its ability to serve the public adequately.

As pointed out above the vast majority of the Company's shareholders have a small investment in terms of dollars. For most, it is a large investment in terms of their own financial resources.

Shares of public utilities have always been attractive to the small investor because risk is at a minimum and the record of growth has been good. In the case of small investors in Nova Scotia the Company's shares were particularly attractive because there are very few other Nova Scotia companies whose shares are listed on stock exchanges. Thus the White Paper proposals would penalize the small utility investor while at the same time rewarding the investor (particularly the small investor) in other widely held corporations.

These comments relate principally to the common shareholder. The position of the preference shareholder is substantially worse. His investment carries a fixed rate of return (as does a bond) but does not provide the mortgage security or the fixed maturity date to which the bondholder is entitled.

If the preference shareholder is not to receive a dividend tax credit, then he will expect a rate of return in excess of that received by the bondholder. The Company is presently marketing an issue of bonds having a 9 3/4% coupon. It is reasonable to expect that a purchaser of preference shares of the Company would require a return of at least 11%.

The Company has outstanding several issues of preference shares. One issue carries a dividend rate of 5%. The market price of these shares has been below par for several years because of more attractive bond yields. The White Paper has further depressed the value of these preference shares so that they can be expected to trade at less than 50% of their par value. This is particularly distressing when 60% of the holders of these preference shares are small investors having an investment (calculated on the basis of par value) of $1,000 or less.

THE COMPANY

While the discriminatory tax treatment proposed by the White Paper appears to be directed against the shareholders it has a direct effect on the Company itself.

The Company is in the business of supplying electricity to the public. The demands of the public are increasing at the rate of about 9% per year. In order to meet these demands, the Company must raise regularly substantial amounts of capital to expand its generation and distribution facilities. This capital is obtained from three sources:

(a) retained earnings;

(b) long term debt;

(c) share capital.

Retained Earnings

Although retained earnings have always been an important source of capital, they are not sufficient alone to finance the expansion demanded by the public.

Long Term Debt

The sale of bonds has been the source of most of the Company's capital. In recent years this source has become more expensive and less available. The Company is currently endeavouring to market its 9 3/4% Series Bonds maturing 1982 in the aggregate principal sum of $6,500,000. While it has been working on this issue for six months, it still does not know what part of the issue can be sold.

Most corporate bond issues are no longer saleable unless they are accompanied by some equity participation. Thus, the adverse effect of the White Paper proposals on the value of the Company's shares impairs its ability to sell its bonds.

Shares:

The White Paper has already depressed the market value of the Company's common shares and if the proposals become law, will depress the market value even further. This substantially reduces the amount of cash that the Company can raise from the sale of its shares.

The sale of preference shares has been an important source of capital for the Company. Total share capital of the Company is approximately $23,500,000, more than half of which is represented by preference shares. The White Paper has substantially aggravated the difficulties in marketing preference shares. The payment, after tax, of a dividend of 11% on shares is approximately equivalent to the payment, before tax, of bond interest at the rate of 22%.

Another method used by the Company in the past to raise equity capital was to issue to its shareholders rights to purchase additional common shares. The depressed market value of the Company's common shares again impairs the ability of the Company to raise capital from this source.

The difficulties the Company will experience in raising share capital will also be reflected in its ability to sell its bonds. These can only be sold if the Company maintains a ratio between debt and equity which is acceptable to prospective bond purchasers. By depressing the value of its shares the White Paper makes it more difficult for the Company to maintain its debt-equity ratio at the level required by bond purchasers.

To summarize the effects of the White Paper on the Company:

(a) The Company must meet not only the normal increasing demands of the public for electricity, but also the demands of industry attracted to Nova Scotia as a result of the regional economic expansion policies of Nova Scotia and Canada;

(b) These demands can be met only if the Company can raise regularly substantial amounts of new capital;

(c) The proposed discrimination against electric utilities has already seriously impaired the ability of the Company to raise capital; and

(d) The Company's position will deteriorate further if the proposals become law.

THE CUSTOMER

Rates charged by the Company for electricity are fixed by the Board of Commissioners of Public Utilities of Nova Scotia. These rates are calculated to permit the Company to earn a just and reasonable return on the capital invested in its electric utility. The cost of financing is taken into account in determining this rate of return. In effect, any increase in the cost of financing will be reflected ultimately in higher electric rates.

This indicates another discriminatory feature of the proposals. Electricity must compete with oil, coal and propane gas. If the Company is forced to raise its electric rates, it suffers a competitive disadvantage. Thus, by treating oil, coal and propane gas companies much more favourably than electric utilities, the White Paper proposals jeopardize the competitive position of electricity.

PUBLIC UTILITIES INCOME TAX TRANSFER ACT

The Public Utilities Income Tax Transfer Act was passed by Parliament in 1966. The principal purpose of the Act was to effect tax neutrality between the taxpaying investor-owned utility and the tax exempt provincial owned utility. The result was to alleviate the pressure on provincial governments to take over the operation of electric utilities. The White Paper proposals would destroy this tax neutrality and negate the underlying principle of the Act by either:

(a) exerting pressure on the provinces to return to utility companies the income taxes rebated by Canada; or

(b) impairing the ability of utility companies to finance expansion to meet the needs of the public.

CANADA'S REVENUE POSITION

Finance Minister Benson, in commenting on paragraphs 4.63 to 4.65 of the White Paper, has said that because of the transfer of funds to the provinces, Canada would be subsidizing the shareholders of utilities if it allowed them tax credits. It is submitted that no such subsidization would occur.

It will be seen from Schedule A that the maximum cost to Canada and the provinces of granting a dividend tax credit to a shareholder with a marginal tax rate of 30% is $35.00 and to a shareholder with a marginal tax rate of 50% is $25.00, in each case per $100.00 dividend. The cost to Canada alone is 72% of these amounts, being $23.93 and $17.10 respectively. Mr. Benson suggests that in the case of electric utility shareholders this is a net tax loss to Canada because 95% (the White Paper proposes 100%) of Canada's taxes collected from the Company are transferred to the provinces.

In fact, Canada would achieve a net revenue gain by

(a) continuing to retain 5% of the income taxes paid by the Company;

(b) continuing to postpone for three years the transfer to the provinces of 95% of the income taxes paid by the Company; and

(c) allowing Company shareholders the same dividend tax credit available to shareholders of other widely held corporations.

This is illustrated on Schedule C.

From this Schedule it will be seen that the gross revenue benefit to Canada per $100.00 of taxes paid by the Company and dealt with as at present under the Public Utilities Income Tax Transfer Act is $25.00.

In summary then, Canada's revenue position after granting dividend tax credits to Company shareholders, would be as follows:

Shareholder's Marginal Tax Rate	30%	50%
Cost to Canada of Dividend Tax Credit per $100.00 Dividend	$ 23.93	$ 17.10
Gross Revenue Benefit to Canada per $100.00 Taxes	25.00	25.00
Net Revenue Benefit to Canada per $100.00 Taxes	$ 1.07	$ 7.90

In 1968 the Company paid tax of approximately $2,500,000 on its electric utility income. If these calculations are applied to that tax and it is assumed that Company shareholders have an average marginal tax rate of 40%, Canada would be better off to the extent of approximately $112,000 by abandoning paragraphs 4.63 to 4.65 of the White Paper proposals than by implementing them.

CONCLUSION

It is submitted that:

1. The only fair and equitable way of dealing with the problems raised by this submission is to recommend against the implementation of paragraphs 4.63, 4.64 and 4.65 in their entirety and treat the shareholders of electric utilities in the same way as the shareholders of every other widely held Canadian corporation; and

2. An announcement to this effect should be made now in order to dispel the financing problems created by the White Paper for the Company and other investor-owned steam, gas and electric utilities.

SCHEDULE "A"

Shareholder with Marginal Rate of 30%

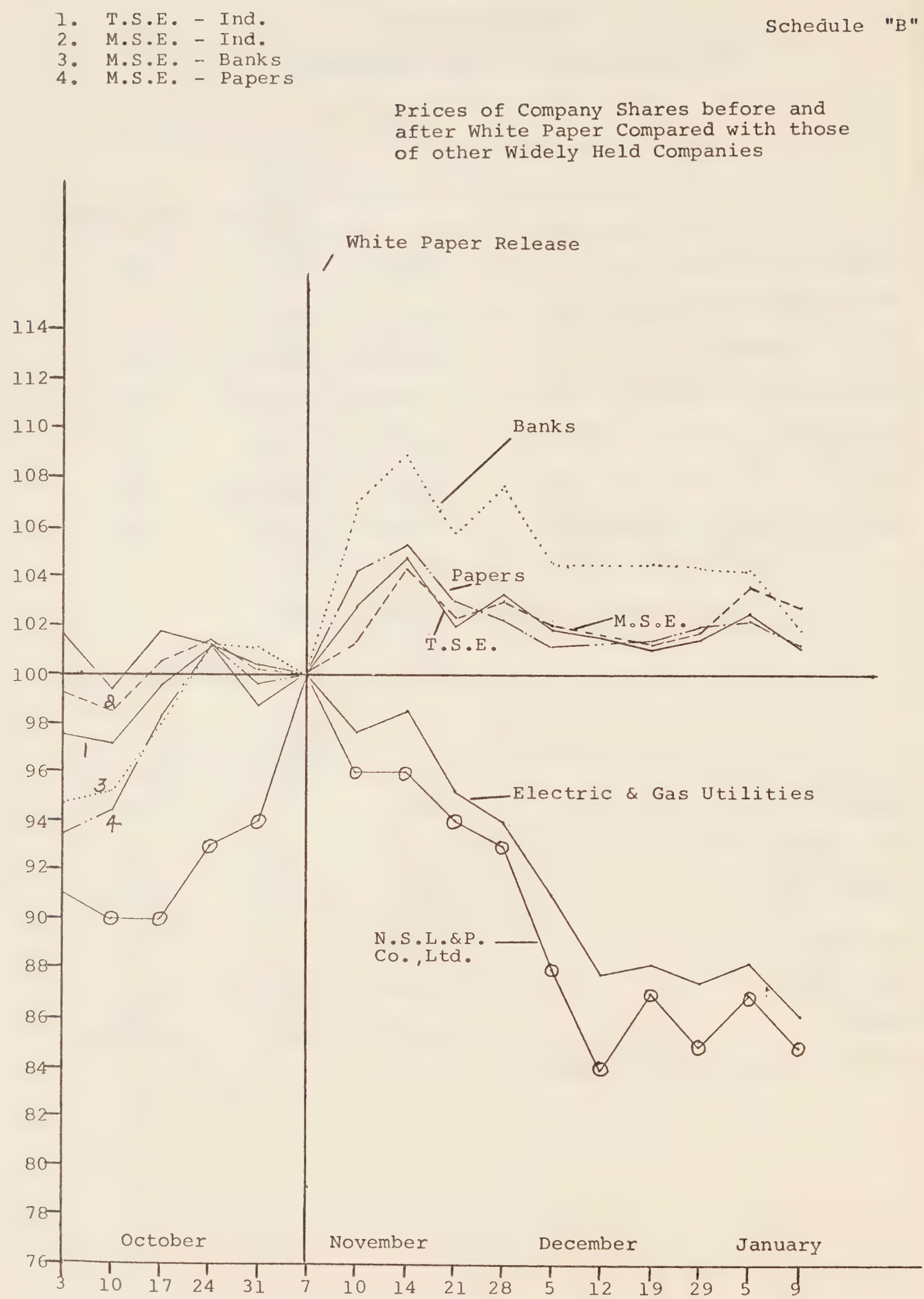
	Now	Proposed	
		Other Widely Held Companies	The Company
Dividend Received	$100	$100	$100
Plus Taxable Credit	-	50	-
Taxable Amount	$100	$150	$100
Gross Tax	30	45	30
Less Credit	20	50	-
Net Tax	10	(5)	30
Amount Retained by Shareholder	90	105	70

Shareholder with Marginal Rate of 50%

	Now	Proposed	
		Other Widely Held Companies	The Company
Dividend Received	$100	$100	$100
Plus Taxable Credit	-	50	-
Taxable Amount	100	150	100
Gross Tax	50	75	50
Less Credit	20	50	-
Net Tax	30	25	50
Amount Retained by Shareholder	70	75	50

Schedule "B"

Prices of Company Shares before and after White Paper Compared with those of other Widely Held Companies



SCHEDULE C

Division of Company's Tax

Assume Taxable Income of $202.60

	Nova Scotia	Canada
Tax Collected	$ -	$ 100.00
Old Age Security Tax (3% of Taxable Income)	-	(6.10)
		$ 93.90
Provincial Corporate Tax (10% of Taxable Income)	20.26	(20.26)
100% of Federal Income Tax		$ 73.64
Present Value of 95% of $73.64 Three years hence @ 8 1/2%	54.74	(54.74)
Division of 100% of Federal Income Tax	$ 75.00	$ 18.90
Plus Old Age Security Tax	-	6.10
Gross Revenue Benefit to Nova Scotia and Canada	$ 75.00	$ 25.00

Net Revenue Benefit to Canada

Assume Dividend equal to Taxes paid of		$ 100.00
Portion of Dividend Paid to Shareholders not entitled to Tax Credit (1)		5.00
Dividend eligible for Tax Credit		$ 95.00
Company Shareholders, Marginal Tax Rate	30%	50%
Tax Credit Cost on Dividend of $95.00 (2)	$ 33.25	$ 23.75
Nova Scotia's Share (28%)	9.32	6.65
Canada's Share (72%)	$ 23.93	$ 17.10
Gross Revenue Benefit to Canada	25.00	25.00
Net Revenue Benefit to Canada	$ -.93	6.48

(1) Company shareholders not entitled to a dividend tax credit are non-resident shareholders, charitable organizations and pension funds. The Company estimates that at least 5% of all dividends paid are received by persons in these categories.

(2) Schedule A shows that under the White Paper proposals the cost to Canada and the Provinces of a dividend tax credit to shareholders with a marginal tax rate of 30% would be $35.00 and to shareholders with a marginal tax rate of 50% would be $25.00, in each case per $100.00 dividend. Because of the facts set out in note (1) above, the dividend subject to dividend tax credit is reduced from $100.00 to $95.00. Ninety-five percent of $35.00 is 33.25 and 95% of $25.00 is 23.75.

APPENDIX B

THE CANADIAN GAS ASSOCIATION

SUBMISSION

TO THE

STANDING SENATE COMMITTEE

ON BANKING, TRADE AND COMMERCE

ON PROPOSALS FOR TAX REFORM 1969

RECOMMENDATIONS ON DIVIDEND TAX CREDITS TO SHAREHOLDERS OF INVESTOR-OWNED GAS DISTRIBUTION UTILITIES

FEBRUARY 26, 1970.

The Canadian Gas Association is the corporate representative and collective voice for the production, transmission and distribution companies and equipment manufacturers of Canada's natural gas industry.

This Association made a "Submission to the Royal Commission on Taxation" and on receipt of its recommendations made a further "Submission to the Honourable Minister of Finance of Canada" which indicates our continuing interest and concern with tax reform.

We are now involved in a detailed study of the "Proposals for Tax Reform".

We will express our views on this White Paper at a later date, including the concept of integration. Our comments at this time, are confined to proposals numbered 4.63, 4.64 and 4.65 which are adversely affecting the equity financing of investor-owned gas distribution utilities.

NEW CAPITAL AND MARKET REACTION

These utilities frequently require substantial amounts of new capital to meet the rapid growth in consumer demand for natural gas. The total investment currently is in excess of 1.5 billion dollars. The timing of financing for these highly capital intensive utility companies is not a matter of choice but is dictated by the growth of their service areas. With the bond market virtually closed by extremely high interest rates, the only other sources open are convertible debt securities and equity financing. The proposed changes would lower the price obtainable on the sale of such securities to the public and would inhibit the availability of these funds. Either alternative can only end

up hurting the customer either in higher rates or reduced service.

The government proposes to alter the method of taxing corporations by establishing a single rate of corporation tax and providing a system of credits to shareholders for corporate taxes paid. For widely-held corporations this system would be roughly equivalent to the present dividend tax credit for taxpayers in the 50 per cent tax bracket and would be more favourable for those in lower tax brackets. It would thus provide an incentive for investment by Canadians in Canadian corporations with creditable tax.

Under paragraph 4.64 the Federal Government proposes to preclude shareholders of investor-owned gas utilities from enjoying the proposed tax credit at the federal level. Even the wording of section 4.65 gives no direction concerning a tax credit for shareholders and past actions of provinces with respect to transfer payments under the Public Utilities Income Tax Transfer Act raise real doubts in this area.

Loss of the present 20 per cent dividend tax credit and denial of the proposed tax credit to shareholders would result in a reduced after tax yield making the investment in these utility shares less attractive. The tax reform proposals discourage investment in these utilities and at the same time offer a substantial inducement for Canadians to invest in other Canadian corporations. The proposals without provincial action would cause a shift from investment in these utilities to other Canadian businesses including non-distribution companies within the gas industry. The financial community has reacted strongly through stock markets to the

proposed changes in the tax structure and the shares of these utilities have already received an unfavourable valuation from the investing public. (See Exhibit A).

ECONOMIC AND TAX OBJECTIVES

A main objective of tax reform is stated in the White Paper to be that the tax system does not interfere seriously with economic growth and productivity. "Taxes by their nature cannot always promote all our economic goals, but they should interfere as little as possible with incentives to work and invest and with the directions our economy follows in meeting demands of consumers and foreign markets". In short, in the absence of a need for incentives to further social policy, taxes should be neutral. Investments needed for productivity and public purposes should not be rejected in favour of less desirable alternatives just because of their tax consequences. The investor-owned gas distribution utilities provide a vital public service. The adverse affect on financing of gas distribution utilities resulting from the proposals is inconsistent with this stated objective.

It is intended that the tax burden be distributed fairly which means that "people in similar circumstances should carry similar shares of the tax load". The tax reform proposals would impose a heavier tax burden on shareholders of investor-owned electric, gas or steam utilities than that carried by shareholders of other Canadian business. This is inconsistent with the stated aim for fairness in taxation.

To maintain the fair value of presently outstanding shares and attract new equity funds, the after tax yield to shareholders of these utilities must be equivalent to that available through alternative comparable investments. One might suggest that gas rates to consumers could be increased to

offset the effect of the denial of the tax credit to shareholders. The rate of return from utility operations would have to be increased to a level substantially higher than the maximum rate of return presently allowed by regulatory authorities. (See Exhibit B).

The Royal Commission on Taxation recognized the need for competitive equality for investor-owned utilities in competition with government-owned public utilities. It also recognized that the solution to the problem of comparable taxation lay beyond its terms of reference as the transfer payments to the provinces under the Public Utilities Income Tax Transfer Act were items of expenditure, not taxation.

CONFUSION OF TRANSFER PAYMENTS WITH TAXES

The proposal that shareholders of investor-owned electric, gas or steam utility corporations in all likelihood will not receive credit on dividends rests upon the justification that 95 per cent (the White Paper proposes 100 per cent) of the taxes paid by these corporations is now being turned over to the provincial governments under the Public Utilities Income Tax Transfer Act. This act was enacted so that these utility companies and their customers could be placed upon a more equitable basis with government-owned utilities. The provincial governments, in turn, could effect the desired equity by rebating amounts equal to the tax to the various corporations. The intention of this Act was that taxes rebated to the corporations would be passed on to the consumers.

The transfer of funds under the Public Utilities Income Tax Transfer Act is similar to other transfer payments from the federal government to the provincial governments also made out of the Consolidated Revenue Fund. The fact that the

source of funds is more readily identifiable is not justification for a difference in tax treatment from other federally collected tax proceeds that find their way into transfer payments to provinces.

In addition, various federal and provincial government assistance programs are available to Canadian industry. The tax reform proposals do not provide for a reduction in the amount of creditable income tax available to shareholders of such benefiting corporations. It would appear that tax sharing has been confused with tax structure in the case of investor-owned gas distribution utilities.

It must be clearly stated that investor-owned gas distribution utilities do pay Canadian income taxes. The denial of the tax credit to their shareholders results in a degree of double taxation on the corporate income.

PROVINCIAL DETERMINATION

To date Alberta has been the only province to enact legislation under which these tax funds are turned over to the gas utility companies for rebate, on behalf of the province to the customers of the utilities in that province. All other provinces have added the transfer payments to their consolidated revenue funds.

The White Paper philosophy by failing to assure that a tax credit be available to gas utility shareholders unfairly projects investor-owned gas distribution utilities into the midst of Federal/Provincial fiscal discussion where they ought to have no standing.

RELATION TO CHANGE IN TAX PROPOSALS ALREADY ANNOUNCED

The recent modification concerning dividends passing from a gas, steam or electric company to its parent company was a welcome indication of intent to be fair on the part of the Government. However, our concern remains with the proposed denial of tax credit to shareholders of gas distribution utilities. It is interesting to note that the elimination of the 33 1/3 per cent tax earlier proposed on the receipt of certain dividends would be unnecessary if the federal government were to grant the tax credit to investor-owned gas utilities on the same terms proposed for other companies generally.

RECOMMENDATION

(1) This most inequitable and discriminatory situation requires immediate correction and cannot be delayed until all submissions on the White Paper have been considered.

(2) We therefore recommend that Paragraphs 4.63, 4.64 and 4.65 be deleted from the proposals for tax reform.

Respectfully submitted

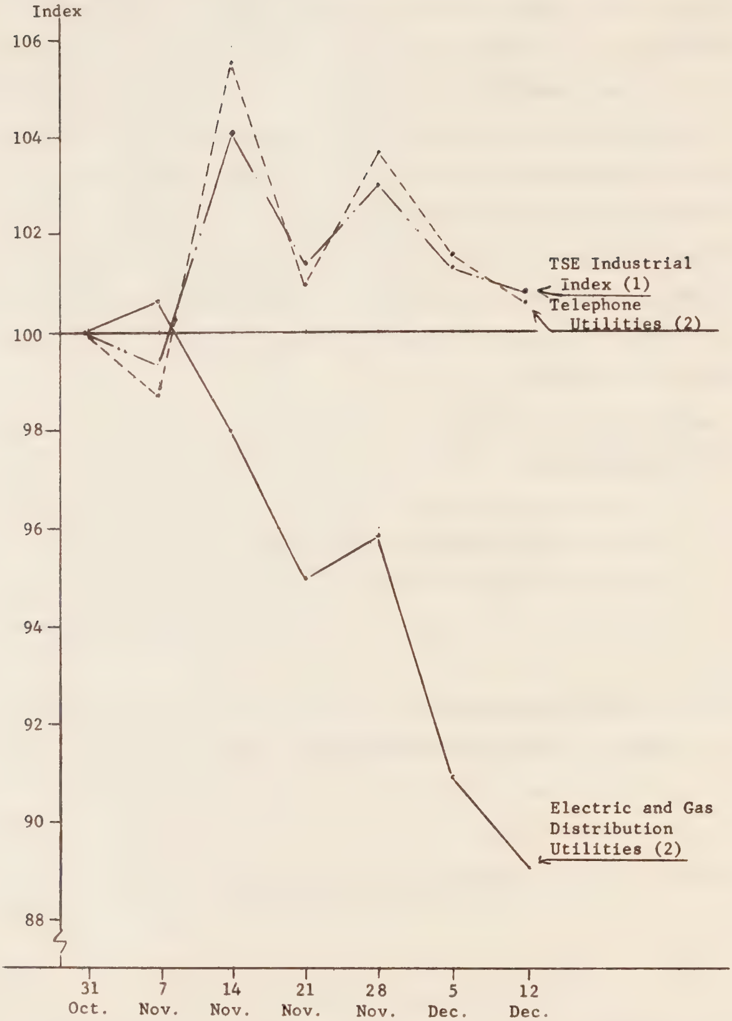
W. H. DALTON
Managing Director

E. C. BOVEY
President

EXHIBIT A

STOCK MARKET TRENDS

October 31 - December 12, 1969



(1) Toronto Stock Exchange Industrial Index (October 31, 1969 = 100)

(2) Utility Indices computed from week-end closing market prices times TSE Industrial Company weightings utilized in TSE Industrial index and reported in the November 1969 Toronto Stock Exchange Review.

Source - Financial Post
- Toronto Stock Exchange Review

EXHIBIT "B"

SHAREHOLDERS' AFTER TAX PROCEEDS ON DIVIDENDS

COMPARISON OF TAX REFORM PROPOSAL BASES WITH PRESENT SYSTEM

	Present		White Paper Proposals: Loss of present 20% dividend tax credit and denial of proposed tax credit		White Paper Proposals: Proposed tax credit in lieu of present 20% dividend tax credit		Increase in return required to provide equivalent after tax yield for (2) with (3)	
Marginal Tax Bracket	33%	50%	33%	50%	33%	50%	33%	50%
	(1)		(2)		(3)		(4)	
Dividend	$100	$100	$100	$100	$100	$100	$150	$150
Gross-up (½ of corp. tax paid)					50	50		
TOTAL	100	100	100	100	150	150	150	150
Tax	33	50	33	50	50	75	50	75
Tax credit	(20)	(20)			(50)	(50)		
Net Tax Payable	13	30	33	50	-	25	50	75
After Tax Proceeds	$ 87	$ 70	$ 67	$ 50	$100	$ 75	$100	$ 75
Increase in return required - %							50%	50%

Assumption

Corporate tax level of 50%, full dividend pay-out (similar to White Paper examples).

Observations

(1) The tax reform proposals for electric, gas or steam utilities would result in a $20. reduction in after tax proceeds per $100 dividend due to the loss of the 20% ($20.) tax credit and the denial of the proposed tax credit available to other Canadian Corporations.

(2) The tax reform proposals for other Canadian corporations with the proposed tax credit to shareholders in lieu of the present dividend tax credit would result in an increase in after tax proceeds of $13. and $5. per $100. dividend for shareholders with marginal tax brackets of 33% and 50% respectively.

(3) To provide shareholders of these utilities with an equivalent after tax yield to that available through alternative comparable investments in other Canadian corporations using the tax reform proposals, a 50% increase in return would be required. To enable this substantial increase regulatory authorities would be required to allow a corresponding increase in the maximum rate of return on utility operations and authorize increased gas rates chargeable to customers. An increase in gas rates to provide an increase of $100. in gross revenue would be required per additional $50. in dividends. Accordingly, the tax reform proposals would result in further competitive inequality in taxation with government-owned utilities.

APPENDIX C

The Consumers' Gas Company

SUBMISSION TO THE

SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

Recommendation on

Tax Credits to Shareholders and Transfers to Provinces

concerning Investor-owned Gas Distribution Utilities

March 1970

The Consumers' Gas Company

TAX CREDITS TO SHAREHOLDERS AND TRANSFERS TO PROVINCES CONCERNING INVESTOR-OWNED GAS DISTRIBUTION UTILITIES

The Consumers' Gas Company has actively participated in the preparation of The Canadian Gas Association Submission to the Senate Committee on Banking, Trade and Commerce concerning sections 4.63, 4.64 and 4.65 of Proposals for Tax Reform and fully supports the Association submission.

In addition, the Company wishes to comment on the potential withdrawal of an incentive to pursue new equity in Canada and to put forward an alternative approach in transfer payments.

Withdrawal of Incentive to Seek New Equity in Canada

Under existing tax legislation, Canadian shareholders receive a 20% dividend credit which is not available on dividends of taxable Canadian corporations to foreign shareholders. As a result, there is an incentive for gas utilities to seek new equity financing in the Canadian market enjoying the dividend credit.

Should the Proposals for Tax Reform be introduced in their present form and should the provinces not cause to be granted a tax credit to gas utility shareholders, then there would be no incentive to such utilities to seek new equity financing from Canadian as against foreign sources. Contrary to the intention of the Proposals to " provide a powerful incentive for investment by Canadians in Canadian

corporations " (Section 1.42) an increase in foreign ownership in gas utilities might well result.

Amrendments to Public Utilities Income Tax Transfer Act

Under the Public Utilities Income Tax Transfer Act, amounts may be paid out of the Consolidated Revenue Fund equal to 95% of income tax collections from gas utilities attributable to gross gas revenues arising in a province. It is our understanding that in recent years the 5% withheld federally may not cover the reduction in federal revenues due to the present 20% dividend credit.

One apparent aim of the Proposals is to provide some flexibility to the provinces in disposition of transfer payments -- whether to customers, municipalities, shareholders or provincial revenues.

Unfortunately in seeking this goal, the initial intention of the transfers to permit refunds to customers has been lost sight of and there is danger of discrimination as between taxpayers finding its way into Canadian tax legislation. The Canadian Gas Association has recommended that this be avoided by removal of the offending sections.

A companion consideration would look to an ammendment to the Public Utilities Income Tax Transfer Act to alter the 100% transfer to the appropriate amount when a tax credit is made available to Canadian shareholders. While we do not know accurately what the remaining transfer could be after covering the cost of such credits, we would estimate that from 60% to 80% would still remain for transfer to the provinces. Hopefully, these transfers could also be advanced over the

approximate 3 year delay after receipt from the utilities presently the pattern.

Recommendation

In addition to the immediate withdrawal of Sections 4.63, 4.64 and 4.65 as recommended by The Canadian Gas Association, we recommend that a change be made in the Public Utilities Income Tax Transfer Act to withhold from transfer payments made available to the provinces the amounts necessary to cover the tax credits granted to utility shareholders, plus administration costs and less interest on any significant delays in making such transfers.

14-15 ELIZABETH II.

CHAP. 43

An Act to authorize the Minister of Finance to transfer to the Provinces a proportion of the income tax payable by certain public utility companies.

[*Assented to 11th July, 1966.*]

HER Majesty, by and with the advice and consent of the Senate and House of Commons of Canada, enacts as follows:

SHORT TITLE.

1. This Act may be cited as the *Public Utilities Income Tax Transfer Act.* Short title.

INTERPRETATION.

2. (1) In this Act, Definitions.

(*a*) "designated corporation" means a corporation whose gross revenue for a taxation year from "Designated corporation."

(i) the distribution and sale to the public in Canada, or the generation and sale in Canada for distribution to the public, of electrical energy or steam, or

(ii) the distribution and sale of gas to the public in Canada,

is more than one-half its total gross revenue other than exempt income for the taxation year;

(*b*) "distribution and sale to the public" and "generation and sale for distribution to the public" mean, respectively, distribution and sale or generation and sale "Distribution and sale to the public" and "generation and sale for distribution to the public."

(i) to a person or persons with whom the vendor deals at arm's length, or

(ii)

(ii) to a person or persons with whom the vendor does not deal at arm's length for resale directly or indirectly to persons with whom the vendor does deal at arm's length; and

"Minister."

(*c*) "Minister" means the Minister of National Revenue.

Words and expressions.

(2) Unless otherwise provided, words and expressions used in this Act have the same meaning as in the *Income Tax Act.*

Distribution of gas to the public in Canada.

(3) For the purposes of this Act,

(*a*) gross revenue of a corporation from the distribution and sale of gas
  (i) in or from portable containers, or
  (ii) to a person whose main use thereof is other than for heating and lighting purposes,

shall be deemed not to be gross revenue of the corporation from the distribution and sale of gas to the public; and

(*b*) a corporation shall be deemed not to have gross revenue for a taxation year from the distribution and sale of gas to the public in Canada if the corporation did not
  (i) have at least one hundred different customers in Canada who consumed the gas distributed and sold to them by the corporation mainly for heating and lighting purposes, and
  (ii) derive at least fifty per cent of its total gross revenue other than exempt income for the year from the distribution and sale of gas to such customers.

Payments to Provinces.

Payments to provinces.

3. (1) The Minister of Finance may pay to a province out of the Consolidated Revenue Fund, at such time or times as he may determine, an amount determined by the Minister in accordance with subsection (2) in respect of the 1966 and each subsequent taxation year of a designated corporation carrying on business in the province.

Determination of amount.

(2) The amount that may be paid to a province under subsection (1) in respect of a taxation year of a designated corporation is 95% of that part of the income tax paid under Part I of the *Income Tax Act* by the corporation for the year that is attributable to its gross revenue for the year from

(*a*) the distribution and sale to the public in the province, or the generation and sale in the province for distribution to the public, of electrical energy or steam; or

(*b*) the distribution and sale of gas to the public in the province.

Tax attributable to gross revenue from sources.

(3) The part of the income tax paid under Part I of the *Income Tax Act* by a designated corporation for a taxation year that is attributable to its gross revenue for the year from

(*a*) the distribution and sale to the public in a province, or the generation and sale in a province for distribution to the public, of electrical energy or steam, or

(*b*) the distribution and sale of gas to the public in a province,

shall, for the purposes of this section, be deemed to be that proportion of the income tax paid under Part I of the *Income Tax Act*, by the corporation for the year that its gross revenue for the year from such distribution and sale or generation and sale in the province is of its total gross revenue, other than exempt income, for the year.

Amounts certified exempt from income tax.

4. Where a province certifies that an amount that is all or part of an amount paid to it under this Act has been paid or otherwise transferred or credited to a designated corporation for its own use and benefit, and certifies the amount that has been so paid or otherwise transferred or credited to the corporation, the amount so certified is exempt from income tax.

Allocation with respect to taxation year 1966.

5. Where part of the 1966 taxation year of a designated corporation is before January, 1966, the amount to be determined by the Minister in accordance with subsection (2) of section 3 in respect of the 1966 taxation year of the corporation is that part of the amount otherwise determined under subsection (2) of section 3 that

(*a*) the number of days in the taxation year that are after December, 1965

is of

(*b*) the number of days in the taxation year.

Regulations.

Regulations.

6. The Governor in Council may make regulations

(*a*) prescribing rules for the determination of any matter to be determined by the Minister under this Act; and

(*b*)

(*b*) generally to carry out the purposes and provisions of this Act.

ROGER DUHAMEL, F.R.S.C.
QUEEN'S PRINTER AND CONTROLLER OF STATIONERY
OTTAWA, 1966

APPENDIX D

SUBMISSION TO THE SENATE COMMITTEE

ON BANKING, TRADE AND COMMERCE

ON WHITE PAPER ON TAX REFORM

BY: CANADIAN UTILITIES LIMITED
CANADIAN WESTERN NATURAL GAS COMPANY LIMITED
NORTHLAND UTILITIES LIMITED
NORTHWESTERN UTILITIES, LIMITED

FEBRUARY 26, 1970.

SUMMARY

1. This Brief is submitted on behalf of four utility companies which operate under a common management and provide natural gas and/or electric service to the general public.

2. The "Creditable Tax" System for Corporations and Their Shareholders

(a) The implementation of the proposal to grant shareholders credits for corporate taxes paid will create conflicts between management and shareholders and inequities of treatment between different classes of shareholders which do not arise under present tax rules.

(b) The proposed system is not required to block loopholes in the existing law.

(c) The proposal that dividend tax credits will not be available unless a corporation is currently paying taxes, tends to nullify the effect of incentives which the White Paper otherwise appears to accept as being desirable.

(d) Continuation of the present system of dividend tax credits is recommended since it appears to create fewer complications than the proposed system.

3. Electric, Gas or Steam Utilities (White Paper Paragraphs 4.63, 4.64, 4.65)

(a) Present legislation provides an opportunity for rebate to individual consumers of the major part of the income tax paid by utility corporations, and this has been placed in full operation in Alberta.

(b) If taxes paid but subject to such rebate are not recognized as "creditable taxes", the shareholders of utility companies will be placed at a disadvantage as compared to the shareholders of other widely held corporations.

(c) The ability of utility companies to raise capital will be impaired unless gas and electric prices to consumers are raised sufficiently to enable utility companies to offset the lack of a dividend credit for shareholders.

(d) The above complications could be avoided by continuation of the present dividend tax credit system. If the Government decides to adopt the proposed "creditable tax" system with respect to dividends, Paragraphs 4.63, 4.64 and 4.65 should be altered so that credit for taxes paid is given regardless of any subsequent transfer of the tax proceeds that may occur.

4. Change of Philosophy

The Government philosophy of providing an opportunity for privately owned gas and electric utilities to offset their disadvantage vis-a-vis publicly owned utilities appears to face the prospect of becoming a casualty of the proposed system of tax reform, unless Paragraphs 4.63, 4.64 and 4.65 are altered.

5. Capital Gains

If the Government decides that capital gains must be taxed, such taxation should, in the interests of a simplified tax system which does not cause any more disruption than absolutely necessary, be limited to gains which are actually realized.

6. Retroactive Legislation

The Government should be aware that one effect of its proposed change to "earned" depletion will be to deprive some companies of the opportunity to recover large investments which were made under former tax rules. Some additional rules should be included to permit amortization of such investments over a series of years.

7. Mining and Petroleum Companies

Changes in the special rules for mining and petroleum companies are expected to have an unfavourable effect on consumer rates. Such companies will pass any increase in effective costs of finding or producing natural gas or coal on to any utility company to which they may be supplying these forms of energy. If the Government chooses to change these special rules, it should be conscious of the fact that it may be indirectly increasing the price at which the individual members of the public receive natural gas and electric service.

1. INTRODUCTION

The four companies on whose behalf the brief is being presented are individual corporate entities engaged under common management in the business of providing either electric or natural gas service, and in some cases both electric and gas service, to the general public.

These companies and the location of their offices are:

1. Canadian Utilities, Limited, Edmonton, Alberta.
2. Canadian Western Natural Gas Company Limited, Calgary, Alberta.
3. Northland Utilities Limited, Edmonton, Alberta.
4. Northwestern Utilities, Limited, Edmonton, Alberta.

The companies provide natural gas service in a widespread area containing 80% of the population of Alberta, including the two major metropolitan areas of Calgary and Edmonton. The electrical operations for the most part are in different geographical areas and tend to be in the more rural and rapidly developing northern sections of Alberta rather than the heavily populated urban areas. The companies, either directly or through subsidiaries, also provide either electric or gas service in certain areas in the Yukon Territory, in the Northwest Territories, in North Eastern British Columbia and in Saskatchewan.

In providing these services, the companies are engaged in all facets of the utility business being involved in

electrical power generation, natural gas production, power and gas transmission as well as the distribution of natural gas and electricity directly to the public. There is a relatively rapid population growth in the natural gas service area, and the energy demand within the electrical service area is experiencing one of the fastest growth rates in Canada at the current rate of 20% per year. Under these conditions there is a constant need for new capital to meet the expanding requirements for utility services arising from the rapid economic development in most of the areas served.

2. "CREDITABLE TAX" SYSTEM

The White Paper proposes a system of credits to shareholders for corporate taxes paid and it does so on the grounds that it will provide a more equitable system and will stop tax abuses. It is our contention that the proposed system will not necessarily be considered more equitable by shareholders and that it is not essential in order to plug loopholes.

With the proposed system of tax credits, conflicts will arise between the management of the corporation, the high income shareholder, the low income shareholder and the non-resident shareholder as to the policies to be followed. For example, the management may be interested in maximizing cash flow to reinvest in plant to meet the expanding needs of its market area. For this reason the management may wish to minimize income taxes and pay dividends at certain times but not at other times. In this regard the proposed system will be more inflexible

than the present system. For example, the corporation may feel obliged to pay income taxes to provide creditable tax, instead of deferring tax by taking advantage of maximum capital cost allowances. Similarly, although cash requirements would make a substantial retention of earnings desirable, dividends may still have to be paid to avoid the expiration of creditable taxes. The proposal that stock dividends can be issued in place of cash dividends does not seem to give a practical alternative. The high income shareholder receiving a stock dividend will in many cases, have additional taxes to pay and yet he has received something of uncertain value. Taxes cannot be paid with a stock dividend and his investment in the corporation has not increased in value. The low income shareholder has a different viewpoint and will probably wish to receive the stock dividend in order to obtain a refund of taxes paid by the corporation.

Another aspect of the conflict that management will have to resolve relates to the foreign shareholder. Creditable tax will be lost to the resident shareholder if cash or stock dividends are not paid. On the other hand, the foreign shareholder does not receive credit for corporate taxes paid and he is subject to withholding tax and possible full taxation in his own country. If the foreign shareholders control the corporation, dividends may not be paid in time to prevent loss of creditable tax by any resident shareholders. If the resident shareholders have control, unwanted dividends may be received by the foreign shareholders.

One of the reasons given for the proposal to adopt the new system of tax credits for shareholders is that it is required to block loopholes. The recent case of Smythe, Smythe and Day has proven that the present income tax act can be used to tax dividend stripping even without Section 138A. Recent cases have shown that the present income tax act prohibits the division of a business into several small corporations in order to obtain the benefit of the low rate of tax in each. Therefore, the prevention of tax avoidance does not appear to be a valid reason for adoption of the proposed system.

The complexities of the proposed system have been lightly treated in the White Paper. If each corporation paid a flat 50% rate of tax on its profit each year and distributed the other 50% in cash dividends each year, the proposed system might not be too difficult to administer.

However, this will rarely be the case. In some instances, due to the exercise of special provisions of the tax rules, low taxes will be paid in year of high earnings and in other years the converse will be true.

In other cases, corporations will be reassessed four or five years after the profits have been earned or receive a refund of such taxes even later. The matching of taxes and dividends will not be an easy task. In addition, where there are more than one class of shares and not sufficient creditable tax, the problem of apportioning the tax must be faced.

In the extractive industries corporations may defer taxes for many years as the result of special rules which are proposed in recognition of the need for incentives in these industries. There would be no creditable tax available for any dividends which may be contemplated during this period. In later years actual taxes paid may exceed reported earnings, such taxes being charged to reserves created when taxes were being deferred. In these years all of the taxes paid may not be creditable. The taxation implications with respect to dividends may well discourage management from taking advantage of the incentive provisions of the special rules for extractive industries and the value of these rules will be partly nullified.

The proposed system of credits for shareholders does not seem to be an improvement over the present dividend tax credit system and there is no reason to suggest that the present system has any flaws in it of sufficient consequence to require it to be replaced. Our companies recommend continuance of the present dividend tax credit system.

3. <u>ELECTRIC, GAS OR STEAM UTILITIES (WHITE PAPER - PARAGRAPHS 4.63, 4.64, 4.65)</u>

Under the Federal Provincial Tax Transfer Agreements concluded in 1947, the Federal Government agreed to pay to the provinces annually an amount which when added to the Provincial corporation income tax would result in the provinces receiving 50% of the total corporation income tax paid by investor owned public utility companies. This

arrangement applied to all such companies engaged in the generation and/or distribution of electrical energy, gas or steam.

In the years following 1947, representations were made to the Federal Government by investor owned electrical utility companies in Alberta and by the Government of Alberta requesting that the federal tax on such companies be abolished, or alternatively that the total tax be rebated to the provinces. In making this representation, the Alberta Government advised the Federal Government that if the latter recommendation was accepted the total tax revenue transferred to the province would in turn be rebated to the utility companies, on the understanding that they would pass it on to their consumers.

The basis for this request was that investor owned utility companies were, by virtue of the federal tax, placed in a discriminatory position as compared with publicly owned utility companies which were exempt from taxation. By abolishing the federal tax or rebating it to the companies, they would be put in a comparable position to publicly owned utilities with which they were forced to compete. Alberta was the most affected of any province by this issue because as a matter of policy, the Government had rejected provincial public ownership of power and gas utilities and as a result investor owned companies were predominant in Alberta.

In its submissions, the Provincial Government argued that it was unsound for the Federal Government to continue a tax situation that put a premium on the nationalization of utility companies. Despite repeated representations, the Federal Government, with the exception of minor recognition of the problem through enactment of Section 85 of the Income Tax Act, rejected such requests to abolish or rebate the entire tax until 1965. At a Federal-Provincial Fiscal Conference in July of 1965 this issue was again raised, both by the Province of Alberta and the Province of Newfoundland. Extensive power development was at that time being proposed in Labrador.

As a result of the representations at that time the Minister of Finance, Mr. Gordon, agreed to recommend that the federal rebate of income tax on investor owned utilities be increased from the prevailing 50% to 95% which the provinces would then be free to rebate to the companies if they so desired, so that the companies could pass the rebate on to their customers. He proposed that the Federal Government should retain 5% of the tax to compensate for the cost to it of giving individuals who were shareholders of the companies concerned the deduction from tax allowed to all Canadian individuals in respect to their dividend income. The federal remission was to be effective from January 1, 1966. A Bill entitled The Public Utilities Income Tax Transfer Act was passed by the first session of the twenty-seventh Parliament in 1966, making effective the Minister's recommendation.

In the same year, the Legislative Assembly of the Province of Alberta enacted a Utility Companies Income Tax Act which provided the mechanism for rebate of the proceeds from the tax transfer to consumers using the utility companies as the disbursing agents. In 1969 the first transfers, which related to 1966 taxes, were received by the provincial governments and by August 1969 disbursements to consumers had commenced in Alberta. The current rebate expressed as a percentage of the consumer's bill for customers of our companies is in most instances in the 4½% to 8½% range. The occupant of a residence in Edmonton, for example, currently pays 8% less for his natural gas service than he did prior to the institution of the tax rebate system.

The proposals for Tax Reform in the Federal Government's White Paper advocates that 100% of the tax be transferred to the provinces but that the Federal Government would discontinue the 20% tax credit on dividends paid to shareholders of investor owned utility companies.

This proposal is in conflict with the first stated aim of the White Paper proposals, which is to establish a fair distribution of the tax burden based on ability to pay. The White Paper proposes that corporations be taxed at a single rate with a system of credit to shareholders for the taxes they pay but the White Paper recommendations expressly preclude shareholders of investor owned utility companies from receiving the proposed tax credit. Such companies are thereby singled out for treatment different to that enjoyed by other corporations.

The theory behind the White Paper proposal seems to be that since 100% of the tax revenue from such companies is turned over to the provinces, the provinces can compensate the utility companies in any way they choose. This assumption is in complete disregard of the facts as they are. With the exception of Alberta, no province has treated federal rebates of tax on utility companies as being different from any other monies paid over under the Federal Provincial Fiscal Agreements. In the case of Alberta, the tax revenue has been rebated to the consumers by arrangement with the utility companies who act as the disbursing agents. If this situation is continued in order to keep the investor owned companies in a comparable position to publicly owned utilities, there remains no revenue at provincial level that could be diverted to the shareholders of the investor owned companies. Furthermore, it would be completely unsound and indefensible for a provincial government to compensate such shareholders for the loss of a federal tax credit. Pertinent to this whole issue is the fact that the tax imposed on investor owned utility companies is a federal tax imposed under a federal statute. It does not in any way become a provincial tax by virtue of the fact that the total revenue is transferred to the provinces under a Federal Provincial Fiscal Agreement.

Paragraph 4.64 of the White Paper proposals is deserving of comment. The paragraph reads:

> "The whole scheme of the present proposals contemplate that shareholders of Canadian corporations receive a credit from the Federal Government for part or all of the Federal Corporation Tax paid by their corporation. It would be contrary to this general scheme if the Federal Government gave to shareholders of these utility corporations credit for taxes which the Federal Government has turned over to the provincial governments and it does not propose to do so."

The validity of the statement is open to serious question. It presupposes that there is some direct relationship between taxes paid by a category of corporations and tax credits allowed by the Federal Government on dividends paid to shareholders of those corporations. This is a situation which, in fact, does not exist. All taxes paid by all categories of corporations go into the Federal Consolidated Revenue Fund and all tax credits authorized under the federal tax laws result in a reduction in the total paid into the Consolidated Revenue Fund by those eligible for the tax credit. Money paid to the provinces by the Federal Government under Federal Provincial Fiscal Agreements is paid from the Consolidated Revenue Fund and is not directly tied to the revenues collected from any particular tax source. It is illogical to argue that this kind of relationship exists in the case of investor owned utility companies when the principle is not, and never has been, applied with respect to vast sums of revenue transferred from the Federal to Provincial Governments under various fiscal arrangements over many years.

The reasons why the abolition of the tax credit to shareholders of investor owned companies is serious, are obvious. Such utility companies of necessity require large volumes of capital to maintain existing systems and to make the extensions necessary to meet rapidly growing customer requirements. The climate currently prevailing in the bond market is such that this source of funds is very limited and extremely costly.

Utility companies which cannot defer capital expenditures are therefore forced to rely on convertible debt securities and the sale of equity stock. Such stock will not be attractive to the public if the holders are denied tax credits on dividend earnings which are available to investors in other forms of corporate enterprise.

Earnings and dividend rates will have to be increased to make utility securities attractive to the investor. The assets of a utility company are devoted to the public service and therefore the capital requirements for expansion are not discretionary and cannot be postponed simply because financial market conditions are not favourable. If sufficient funds cannot be raised, consumers will not obtain the services they require unless rates are raised in order to give a competitive return to the investor who will be providing the funds. The Government of Canada's tax policies will probably be blamed for these increased rates.

The examples set forth in Schedule 1 and 2 illustrate that increases in natural gas consumer costs of up to 10% can be the direct result of application of the White Paper proposals. A similar example calculation for a typical electric utility would reveal the possibility of a need for a somewhat greater increase.

The examples do not reflect any increase in cost of financing with respect to the portion of capital requirements traditionally obtained by issuance of preferred shares. If this class of security remains marketable, a similar increase in earnings and dividend yields will be required for any new issues. It should be noted however that nothing could be done to affect the loss of value, which will be suffered by the present holder of utility preferred shares as a result of the loss of a dividend tax credit. Historically, preference shares have been a popular investment for individuals with relatively low fixed incomes to whom preferred shares were attractive by virtue of the 20% tax credit.

Our companies recommend continuation of the present system of granting a deduction from tax to all Canadian shareholders in respect to their dividend income. Under that system the shareholders of utility companies are not placed at any disadvantage.

If the Government decides to adopt the new "creditable tax" system of allowing tax credits on dividend income, Paragraphs 4.63, 4.64 and 4.65 should be altered so that credit is granted for all taxes paid by utility corporations regardless of any subsequent transfer of the tax proceeds which the Government may choose to make.

4. <u>CHANGE OF PHILOSOPHY</u>

In previous years the Government has given serious consideration to the problem of the privately owned utility which is subject to income tax compared to publicly owned utilities which are not. As has been previously indicated, a certain philosophy was developed, over a period of many years, as first evidenced by the enactment of Section 85 of the Income Tax Act and ultimately by The Public Utilities Income Tax Transfer Act.

It would appear that the authors of the White Paper, having determined to actively pursue the "creditable tax" system as a main basis for their proposals, unexpectedly found that they had resurrected a problem for privately owned utilities. They have made no attempt to find a solution for this and their Paragraphs 4.63, 4.64 and 4.65 will have the ultimate effect of positively denying the relief previously given to the privately owned utilities unless those paragraphs are altered so as to permit tax credits to be granted to utility shareholders.

5. <u>CAPITAL GAINS</u>

Our companies believe that one of the most disrupting features for both business and individuals of the White Paper is the proposal to tax unrealized capital gains on

investments in widely held corporations every five years. The five year revaluation will require companies with large holdings in widely-held corporations to pay substantial amounts of tax when market prices of securities increase. Market prices are not indicative of amounts that could be realized if large blocks of shares were suddenly put on the market. If a corporation is wholly-owned by a non-resident corporation, this provision will prevent shares being offered to the public. In cases where the public presently owns an interest in such a corporation, the proposal will give a strong incentive to the parent corporation to acquire the outside interest to prevent revaluation.

The four companies on whose behalf this brief is presented, are subsidiaries of International Utilities Corporation, which is incorporated in the United States, but is resident in Canada and, as such, is subject to Canadian income tax, and whose shares are listed on the Toronto Stock Exchange. Two of the four companies, namely, Canadian Western Natural Gas Co. Ltd. and Canadian Utilities, Limited are not wholly owned and their common shares are also listed on the Toronto Stock Exchange. It can be foreseen that companies of this sort may have to be restructured to mitigate the effects of revaluation and the creditable tax proposals.

6. RETROACTIVE LEGISLATION

The implementation of the White Paper recommendations may have some unfortunate retroactive results. Perhaps this can be best illustrated by one factual example.

Up to 1962 the acquisition cost of oil or gas properties was treated as a non-deductible capital cost. The only way to recover this cost was out of a depletion allowance from taxable income. In 1962 the Government agreed that such costs should be tax deductible but the legislation was not retroactive, and expenditures incurred prior to April 10, 1962 could still only be recovered out of depletion allowances.

Canadian Western Natural Gas Company Limited had made such an expenditure prior to the 1962 legislation. It had purchased the Carbon gas field near Calgary for approximately 4¼ million dollars in 1958.

By the end of 1969 the company has recovered only $570,000 against this expenditure. The change in depletion recommended by the White Paper will, in a retroactive manner, preclude the company from any further recovery of this investment since new expenditures have to be made before any further depletion is "earned".

If the government decides to adopt the "earned" depletion concept, it should also provide some opportunity for companies such as ours to amortize over a series of years their unrecovered costs in past investments of this type.

7. DEPLETION

A public utility must maintain careful control over its costs of operation. If its costs go up it must obtain approval from governmental regulatory boards to increase its rates to consumers. The consumers include practically every person living in its area of service. These people are justifiably vocal and insist on being given reasons for cost increases.

Depletion may appear to most persons to be remote from public utilities but such is not the case. To the extent that a reduction of depletion to petroleum companies results in an increase in the price of natural gas to the utilities, rates will have to be increased.

Electric utilities in Alberta are already, to a considerable degree, using coal to produce electricity and the trend is certainly toward a much greater use of this particular energy source. If the cost of coal is increased through elimination of the three year exemption for new mines and through a reduction in depletion granted the mining industry, the utilities rates will have to be increased. Our companies wish to draw this situation to the attention of the government so that it will be given due consideration when a decision has to be made whether or not to adopt the proposed changes for the special rules for mining and petroleum companies.

8. CONCLUSIONS

Our four utility companies, for the reasons set forth in this brief, wish to respectfully submit that in their opinion:

(1) The present system of providing dividend tax credits for Canadian shareholders should be continued.

(2) If the present system of providing dividend tax credits is replaced by the "creditable tax" system, utility shareholders should be permitted to receive credit for taxes paid by utility corporations regardless of subsequent transfers of tax proceeds.

(3) If taxation of capital gains must be implemented, it should not be applied to unrealized gains.

(4) If the "earned" depletion concept is adopted for the mineral industry, additional rules should be provided to permit amortization of past investments.

(5) Due regard should be given to the impact on consumer costs when the pros and cons of the proposed changes in special rules for mining and petroleum companies are being weighed.

John Maybin

JOHN MAYBIN
Chairman and Chief Executive
Officer

February 26, 1970.

SCHEDULE 1.

Schedule to Illustrate Higher Level of Earnings Required to Provide a Competitive Return to Utility Shareholders under the White Paper Proposals.

	Marginal tax rate of Shareholders			
	30%		50%	
	Utility Company	Non-Utility Company	Utility Company	Non-Utility Company
Earnings before tax	$300	$200	$300	$200
Tax paid by corporation	150	100	150	100
Dividend to shareholder A	150	100	150	100
Add creditable tax	-	50	-	50
Taxable amount to shareholder	150	150	150	150
Tax before credit	45	45	75	75
Less creditable tax	-	50	-	50
Net tax (refund) B	45	(5)	75	25
Realized by shareholder A-B	$105	$105	$75	$75

To obtain the same net cash return for the respective shareholders, it can be seen that the earnings before tax must be 50% higher for the Utility Company than for the Non-Utility Company.

The Utility Company in this example is a widely-held Canadian company paying corporate income tax at a 50% rate but subject to the provisions of White Paper Paragraphs 4.63, 4.64 and 4.65; and the Non-Utility Company is any other widely-held Canadian company paying corporate income tax at a 50% rate.

SCHEDULE 2.

Calculation of Required Increase in Consumer Rates Needed to Provide 50% Greater Earnings for one of the Companies submitting this Brief.

Canadian Western Natural Gas Company Limited

Net Income, year ended December 31, 1968	$2,787,000
Assume no adjustment can be made for existing preferred shareholders - deduct dividend requirement	440,000
	$2,347,000
Assume 50% increase required in net income available for common	$1,173,000
Increase required in gross revenue, twice above (to compensate for increased income tax)	$2,346,000
Gas sales revenue - 1968	$23,433,000
Required increase equivalent to	10%.

APPENDIX E

NEWFOUNDLAND LIGHT & POWER CO. LIMITED

SUBMISSION

TO THE

STANDING COMMITTEE ON BANKING, TRADE AND COMMERCE

OF THE

SENATE

ON

PROPOSALS FOR TAX REFORM

March 1970

NEWFOUNDLAND LIGHT & POWER CO. LIMITED
SUBMISSION
ON
PROPOSALS FOR TAX REFORM

PREFACE

On the authority of the Public Utilities Income Tax Transfer Act, amounts equal to 95% of the income taxes paid by designated public utility corporations under Part I of the Income Tax Act may be paid out of the Consolidated Revenue Fund to the provinces in which the income originated. Sections 4.63 through 4.65 of the Proposals for Tax Reform introduced by the Hon. E.J. Benson, Minister of Finance, in November 1969 apply specifically to these designated electric, gas and steam utility corporations.

The Newfoundland Light & Power Co. Limited is one of the designated corporations. It generates and distributes power[1] in Newfoundland, serving nearly 100,000 customers in urban and rural communities. The Company operates under the jurisdiction of the Public Utilities Act of Newfoundland which is administered by the Board of Commissioners of Public Utilities of Newfoundland. It is the first utility in Eastern Canada to serve urban and rural customers at uniform rates for each classification of service. That these rates are reasonable is indicated by the fact that a family living in a small village in Newfoundland, and using an electric range and electric water heater, now pays less for its electricity than a family using the same amount in any village, town, or city on the eastern seaboard of Canada and the United States.

The provisions contained in Sections 4.63 through 4.65 of the Proposals for Tax Reform are not new. They, like most of the tax reform proposals, arise out of the report, popularly known as the Carter Report, made in 1967 by the Royal Commission on Taxation. In September 1967, Newfoundland Light & Power Co. Limited wrote to the former Minister of Finance, the Hon. Mitchell Sharp, expressing its concern over the unhappy atmosphere created by the Carter Report with respect to the prospective treatment of utility shareholders by the Federal taxation authorities. The same atmosphere, with an added flavour of imminence, has been reborn as a result of the more recent Proposals for Tax Reform.

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(1) 939, 447, 448 kwhrs were produced and purchased in 1969 for distribution to the public.

NEWFOUNDLAND LIGHT & POWER CO. LIMITED
SUBMISSION
ON
PROPOSALS FOR TAX REFORM

SUMMARY

Newfoundland Light & Power Co. Limited supplies electricity to more than three-quarters of the people of Newfoundland. It distributes nearly a billion kilowatt-hours annually to 100,000 customers in urban and rural communities. Its rates are low. A Newfoundland family using an electric range and water heater now pays less for its electricity than any similar family living on the eastern seaboard of Canada or the United States.

It is proposed in paragraphs 4.63 to 4.65 of the White Paper that the Public Utilities Income Tax Transfer Act be amended so that an amount equal to 100% of the Company's corporation tax (instead of the present 95%) would be paid to the Province, and the Company's shareholders would be subjected to heavier taxation by being denied the tax credits allowed the shareholders of all other companies. On the basis of the Company's earnings and dividends in 1969, this proposal would require payment of income taxes of $617,000 by the shareholders of Newfoundland Light instead of $154,000 which they would pay if they were treated the same way as shareholders of other widely-held corporations.

The reason for this apparent inequity seems to be that payments made to the provinces by the Federal Government from the Consolidated Revenue Fund on the authority of the Transfer Act are based on the amount of the income taxes paid by the utility companies, whereas payments made to the provinces from the same fund on the authority of other Acts or Orders-in-Council for such purposes as hospitals, medicare, roads, education, etc. are not based on the amount of the income taxes paid by the other companies. In fact an amount equal to all or most of the corporation taxes paid by all the companies in each province goes back to that province. Thus it is difficult to see why the Power Company's shareholders should be expected to pay four times as much personal income taxes as other shareholders merely because the Transfer Act specifically states that an amount equal to 95% of the income tax paid by the Company will be so paid to the province.

The stock market has already reacted to the proposed discrimination and the market value of the shares of the designated utility companies has dropped by about $200,000,000.

The proposed discrimination has also made it impossible for the Company to obtain funds for the expansion of its undertaking at reasonable cost.

The Company contends that the Federal Government would be better off if it abandoned its proposed plan. Taking into account the disposition of the income taxes levied by both governments, the Federal Government would benefit by $54,000 per annum if it keeps the Tax Transfer Act in force without change and allows Newfoundland Light & Power shareholders to claim dividend tax credits available to shareholders of all other widely-held corporations.

If the proposed plan were adopted, the Company would then have to increase its payments to investors and, in turn, the cost of electricity in Newfoundland would have to be increased by about $1,500,000 a year. All the Company's customers would suffer. The Company is strongly opposed to such an increase in its rates.

All of the required increase in the Company's revenue would have to be paid out, half to shareholders, half in further corporate income taxes. The shareholders receiving the required increase in dividends would in turn pay more income taxes. The increases in company earnings and dividends required to offset the heavier taxation would make the Company more attractive as an investment by foreigners and thus the stage would be set for the takeover of another Canadian company by foreign interests, a company in which there is now only about one per cent of foreign ownership.

It is the considered opinion of the Company that the proposed plan would give rise to a chain reaction which would result in damage to the Company, damage to the shareholders, and an increase in the cost of living to more than three-quarters of the households of Newfoundland. The elimination of the proposed plan would not detract in any way from either the basic principles or the procedures of the White Paper as a whole. The Company therefore respectfully requests that paragraphs 4.63 — 4.65 be removed from the White Paper.

NEWFOUNDLAND LIGHT & POWER CO. LIMITED SUBMISSION ON PROPOSALS FOR TAX REFORM

THE PROPOSALS FOR TAX REFORM AND THEIR IMMEDIATE EFFECTS

If Sections 4.63 through 4.65 of the Proposals for Tax Reform were to take the form of legislation, the result would be payment by the Federal Government to the appropriate provincial authority of amounts equal to 100%, rather that 95%, of the corporation taxes collected from the utilities. Shareholders of utility corporations, however, would suffer the disadvantage of being placed in a fiscal position unique among corporations. They would be denied the tax credit benefits available to the shareholders of all other widely-held corporations.

The authors of the Proposals for Tax Reform apparently regard the taxes paid by utilities as characteristically different from those paid by other corporations. From the tone of the Proposals, it would appear that the Federal Government considers that the peculiar treatment given to the utility taxes it receives, namely, the subsequent payment from the Consolidated Revenue Fund to the provincial authorities of amounts equal to 95% of the corporation income taxes paid, justifies peculiar treatment of the shareholders who invested their capital in the hope of sharing in the profits which the utility companies might earn. Utility taxes seem to be thought unique in that they are earmarked for return to the provinces; they are not looked upon as being placed in a common pot along with the taxes from other corporations from whence they can be distributed to the provinces in accordance with various federal-provincial fiscal arrangements. Rather, it seems they are considered to be received by the Federal Government and paid directly to the appropriate provincial authorities under the Public Utilities Income Tax Transfer Act. But in fact they are paid into the Consolidated Revenue Fund in the same way as the taxes collected from all other corporations. Furthermore, a significant proportion of all the taxes paid into the Fund, although not specifically earmarked, are also returned to the provincial governments for such purposes as hospitals, medicare, roads, education and so on, on the authority of Acts or Orders-in-Council. Because their sources are not identified, all payments to the provinces except those authorized by the Transfer Act, will be ignored in calculating the personal income taxes to be paid by the shareholders. None but the utility shareholders will be penalized. In fact an amount equal to all or most of the corporation taxes paid by all companies in each province goes back to the province. In 1967 the Federal Government collected corporation taxes totalling

$1,630,000,000[1] and in the same year paid the provincial governments and municipalities a total of $1,992,000,000[1]. The corporate income taxes of electric, gas and steam utilities were $40,500,000 [2] in the same year and amount to only 2.5% of all corporate taxes.

It is further submitted that in any event the distinction between the taxes to be paid by utility shareholders and the taxes paid by shareholders of other corporations is not well founded, as it is predicated on a consideration not of the nature or source of the taxes but of their intended use. Utility companies now and doubtless always will be subject to income tax. Why, then, must a utility pay tax in the same manner as other corporations and then be governed by what the payee intends to do with the moneys paid?

The tax treatment of utilities proposed by the Federal Government is inequitable in that it leads to double taxation. The Proposals for Tax Reform would render fully taxable in the hands of the utility shareholder earnings on which tax had been paid before distribution. In this respect utility companies and their shareholders would be isolated for special treatment. They alone would be the object of an income tax discrimination.

The securities markets recognized the discrimination immediately after the Proposals for Tax Reform were published. The tabulation below compares the stock prices of a group of telephone utilities which were unaffected by Sections 4.63 through 4.65, with those of a sample of electric and gas utilities to which the Proposals would apply. The prices are quoted prior to the issuance of the Proposals on November 7th and as at November 28th, 1969.

The market statistics clearly indicate that whereas the prices of telephone company shares advanced, those of the electric and gas utilities declined after publication of the new tax proposals. The total market value of electric and gas utility shares relative to telephone utility shares between November 7th, 1969 to January 30th, 1970 as shown in Appendix I fell by nearly $200,000,000. Investment dealers have already advised their clientele on this matter. For example, Bongard Leslie, in its special report on the White Paper of November 17th, 1969, advised investors as follows:

> "Present holders of common and preferred utility stocks such as Newfoundland Light & Power, Nova Scotia Light and Power, Gaz Métropolitain Consumers' Gas, Union Gas, Northern and Central Gas, Great Lakes Power, International Utilities and all of its Alberta subsidiaries, Inland Natural Gas and Calgary Power should give serious consideration to eliminating these commitments from their portfolios."

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(1) Source: Canadian Statistical Review, Dominion Bureau of Statistics, December, 1969.
(2) Source: Corporation Taxation Statistics, Dominion Bureau of Statistics, 1967.

TELEPHONE, ELECTRIC AND GAS COMPANY SHARE PRICES

	Price per Share	
Telephone Utilities*	Nov. 7th ($)	Nov. 28th ($)
B.C. Telephone	69	70
Bell Canada	42	44-1/4
Maritime Telegraph	16-3/4	16-7/8
New Brunswick Telephone	11-7/8	12
Electric and Gas Utilities*		
Calgary Power Ltd.	25	23-1/2
Calgary Power Ltd. — Convertible Pfd.	107	95
Consumers' Gas	16	16
Newfoundland Light & Power Co. Limited	7-7/8	7-1/4
Nova Scotia Light and Power Company, Limited	8-3/8	7-7/8
Northern and Central Gas	17-3/8	15
Union Gas	16	15-5/8

*Common Shares unless otherwise noted.
Source: Financial Post November 15, 1969 and December 6, 1969.

This market reaction has created an acute problem for Newfoundland Light & Power Co. Limited in the area of corporate financing.

FINANCIAL PROBLEMS

Newfoundland Light & Power Co. Limited is a growth company. The power requirements of its customers have grown over the past three years at an annual rate of 17%. Its capital expenditures now average approximately $6 million per annum.

The Company's capitalization at December 31st, 1968 was made up of a total of $29,462,000 First Mortgage Bonds, $3,954,000 General Mortgage Bonds, $5,714,000 Preferred Stock and $20,679,000 Common Equity. To provide funds for expansion, the Company has raised money through the sale of both debt and equity securities. The most recent issues of new securities have been First Mortgage Bonds. In 1966, $5,000,000 Series "R", 20-year, 7% bonds were issued, and in 1968 $3,000,000 Series "S", 20-year 7-3/4% bonds were sold to the public.

In December 1968, the Company filed a prospectus for the sale of $3,000,000 of First Mortgage Bonds and although it received the approval of the Ontario and Quebec Securities Commissions, the Company felt obliged to withdraw the issue because of unfavourable market conditions. During 1969 the Company curtailed its capital programmes but nevertheless added significantly to its bank loans. As at December 30th, 1969, it owed $7,500,000 to its banks. In 1970 the capital expenditure forecast and the requirement to refinance an issue of first mortgage bonds will increase the Company's bank loans to $10,500,000, if financing is not carried out before next autumn.

During the past year the condition of the bond market had worsened to the point where the Company had given up hope of being able to sell additional long-term first mortgage bonds. In order to finance some of its short-term obligations, it was planning an issue of debentures with warrants to purchase common stock at a specified price. While the Company is well known in the Atlantic area where over half of its common shares are held, it is not as well known in Ontario and Western Canada. In order to provide Ontario and western investors with better market accessibility and information with respect to its common stock, Newfoundland Light & Power Co. Limited listed its common shares on the Toronto Stock Exchange in November 1969 as a necessary step prior to offering debt securities with the common share purchase warrants attached. This whole effort has been nullified, however, by the effect of the Proposals for Tax Reform and the Company has a serious and immediate problem with respect to long-term financing.

TAXES PAID BY NEWFOUNDLAND LIGHT AND ITS SHAREHOLDERS

Corporation tax paid by Newfoundland Light & Power Co. Limited in 1969 amounted to $1,742,580.(1) Of this amount about $432,000(1) is collected by the Federal Government on behalf of the Province of Newfoundland and promptly returned to the Province. In addition, under the terms of the Public Utilities Income Tax Transfer Act, the Federal Government will pay approximately $1,150,000(1) to the Province of Newfoundland in 1972. Taking into account the provisions contained in the Proposals for Tax Reform, the payment to the Province of Newfoundland would rise to about $1,750,000 because utility taxes would be increased and the amount to be paid would be 100% of the tax collected from the Company.

In addition, based on 1969 figures and on the proposed absence of any dividend tax credits, the Federal Government would collect from tax on shareholders of Newfoundland Light & Power Co. Limited an estimated $617,000(2). If the Company's shareholders were treated like those of all widely held corporations,

(1) See Appendix II, Schedule A

(2) Based on dividends of $1,542,800 and average marginal tax at 40% (see Appendix II, Schedule C)

the shareholder taxes would amount to an estimated $154,000,[1] or about one-quarter of what is proposed. It is not surprising, therefore, that the shares of Newfoundland Light & Power Co. Limited and other electric and gas utilities are now viewed with disinterest by the prospective investor. It is also worthy of note that 73% of the shareholders of Newfoundland Light & Power Co. Limited common stock live in the Atlantic Provinces, that their average holding is only 450 shares, and that together they own 59% of the outstanding common stock. Less than one percent of the common shares are held outside of Canada. The White Paper plan deals harshly with small shareholders of limited means. If such a shareholder owns 200 shares in the Power Company and has a marginal tax rate of 30% he will pay a tax of $30 on his $100 of dividends, whereas if the shares were those of a telephone company, he would receive a net tax refund of $5 for the same investment. On the other hand, taxes on dividends received by non-residents will be unaffected by the provisions of Sections 4.63 – 4.65.

The Honourable Mr. Benson, Minister of Finance, speaking on a motion to refer the Proposals for Tax Reform to the House of Commons Standing Committee on Finance, Trade and Economic Affairs, announced that the Government was prepared to make a modification concerning dividends passing from an electric, gas or steam utility corporation to its parent company. Although the Government thus appears to be prepared to assist the large corporate shareholder (the parent of a utility company), nothing has been done to alleviate the critical burden which would be placed on the shoulders of smaller shareholders.

The Honourable Mr. Benson, after speaking to the Board of Trade in St. John's on January 26th, 1970 and in answer to questions raised by Company officials attending the meeting, contended that the Federal Government, because of the transfer of funds to the provinces, would be subsidizing the shareholders of the utilities if it allowed them tax credits. Analysis of the disposition of the income taxes of Newfoundland Light & Power Co. Limited and its shareholders as shown in Appendix II does not support his allegation. On the contrary, it indicates that based on 1969 tax payments, continued distribution of taxes in pre-White Paper proportions, and taking into account the benefit from the use of the tax payments retained by the Federal Government for three years prior to transfer to the provinces, the Federal Government would benefit by approximately $54,000 if it cancelled the plan proposed in paragraphs 4.63 – 4.65. The fact that the Federal Government does come out about even indicates that the 95% stated in the Public Utilities Income Tax Transfer Act is reasonable. With this being the case, it is respectfully submitted that the utility shareholders could be treated in the same way

(1) Based on dividends of $1,542,800 and an average marginal tax rate of 40% but with allowance for full gross of dividends and credit for corporate tax payments.

as shareholders of other widely-held corporations without cost to the Federal Government, and that the Income Tax Transfer Act should remain in force and unchanged.

ALTERNATIVE COURSES OF ACTION OPEN TO NEWFOUNDLAND LIGHT & POWER CO. LIMITED

It is suggested in the Proposals for Tax Reform that the utilities negotiate with the provinces on the matter of their turning over to the corporation or its shareholders some portion of the corporation taxes passed on to each province. There appears to be no way that a practical procedure could be worked out which would be uniform throughout Canada and which would succeed from the economic viewpoint of the company or its shareholders. The provinces presently receiving utility income tax payments from the Federal Government have committed the funds for other provincial purposes, in some cases returning the rebate to the utility customers or to the municipalities in which the revenue originated, but not to shareholders. In the case of Newfoundland Light & Power Co. Limited and the Province of Newfoundland, there has been no agreement to return part or all of the utility income taxes to either the customers, the Company or the shareholders. Newfoundland has already committed these funds for other provincial purposes.

If the utilities are unable to convince the Federal Government to remove paragraphs 4.63 through 4.65 from the Proposals for Tax Reform, which would be an equitable and practical solution, the only recourse that Newfoundland Light will have will be to apply to the Public Utilities Board of Newfoundland for an increase in consumers' rates. If the Company is to attract capital in today's markets and in the context of the additional burden which the Government proposes to impose, it must increase its earnings substantially and pay out larger dividends to its shareholders. If the utility shareholder is to pay taxes on his dividends in the same way that he pays taxes on bond interest, the Company will have to increase his dividends so that his after tax income will be equal to that which he would have obtained had utility shareholders been treated the same as shareholders of all other widely-held corporations. Using 1969 data it is estimated that the price of electricity to over three-quarters of the people of Newfoundland would have to be increased so as to bring in an estimated additional $1,544,000 of revenue. It is interesting, as shown in the analysis in Appendix III, that the entire amount of the additional revenue ends up in the Government's hands, $772,000 through the payment of more corporation tax and $772,000 through the payment of additional taxes by shareholders. No additional funds arising out of the rate increase would remain with the corporation or its tax-paying shareholders.

Such an increase in earnings and dividend payments would in turn provide an incentive for purchase of the Company's shares by foreigners who are unaffected by the loss of dividend credits applicable to resident shareholders. Thus the stage would be set for the takeover of another Canadian company by foreign interests, a company in which there is currently only about one per cent foreign ownership.

The ownership of utilities in Canada varies from province to province. There are provincially-owned, municipally-owned and investor-owned electric and gas utilities. The Public Utilities Income Tax Transfer Act has proven equitable and successful in that it returns the income taxes of the investor-owned utilities to the provinces in which these taxes are collected and thus gives the provinces control of all revenues and the income taxes of their utilities regardless of ownership. In Newfoundland, the Newfoundland and Labrador Power Commission generates electricity and sells it wholesale, but electricity is distributed to the public principally by Newfoundland Light & Power. The 1966 report of the Newfoundland Royal Commission on Electrical Energy recommended that both provincially-owned and private enterprise continue their utility businesses in Newfoundland. The Royal Commission reported that the Transfer Act removed any incentive for the Province to take over the privately-owned utilities then existing. Since that time the several privately-owned small electric utilities, with the approval of the Newfoundland Government, amalgamated into the Newfoundland Light & Power Co. Limited. It is unfortunate that if the Proposals for Tax Reform become law, this new enterprise, its shareholders and consumers will be damaged.

In conclusion, it is the recommendation of this submission that the equitable and practical solution to this dilemma is the removal of paragraphs 4.63 through 4.65 from the Proposals for Tax Reform. Their elimination would not detract in any way from either the basic principles or the procedures proposed by the White Paper.

Respectfully submitted,

A. Bailey

A. Bailey, President

APPENDIX I

NEWFOUNDLAND LIGHT & POWER CO. LIMITED

CHANGE IN TOTAL MARKET VALUE OF LISTED PREFERRED AND COMMON SHARES OF UTILITY GROUPS

	Change in Market Value from November 7, 1969 to:—		
	November 28, 1969	December 31, 1969	January 30, 1970
(1) 15 Major Electric and Gas Utilities*	-7.14%	-13.11%	-16.51%
(2) 5 Major Telephone Utilities**	+4.60%	+4.26%	-2.96%
(3) Relative change in Electric and Gas Utilities as compared to Telephone Utilities (1) – (2)	-11.74%	-17.37%	- 13.55%
(4) Relative drop in total Market Value (3) × $1,451 million*	$170 million	$252 million	$197 million

* The total market value of the Electric and Gas Utility group was $1,451 million on November 7, 1969

** The total market value of the Telephone Utility group was $1,804 million on November 7, 1969.

NOTES:

(1) See Schedule A for calculation of change of market value of 15 Electric and Gas Utilities.

(2) See Schedule B for calculation of change of market value of 5 Telephone Utilities.

NEWFOUNDLAND LIGHT

CHANGE IN TOTAL MARKET VALUE OF LISTED PREFERRED

Company	Type of Security	Number of Shares	November 7, 1969 Price $	November 7, 1969 Total Value $
Calgary Power	Common	5,250,000	25.00	131,250,000
	5% Pfd.	40,000	75.00	3,000,000
	5.4% Pfd.	150,000	107.00	16,050,000
Canadian Utilities	Common	886,000	39.12	34,687,200
	4-1 4% Pfd.	15,000	57.00	855,000
	5% Pfd.	40,000	71.75	2,870,000
	6% Pfd.	50,000	83.00	4,150,000
Canadian Western Nat. Gas	Common	1,780,000	17.00	30,260,000
	4% Pfd.	274,410	11.00	3,029,500
	5-1 2% Pfd.	200,000	15.25	3,050,000
Consumers' Gas	Common	17,463,087	16.00	279,409,400
	5-1 2% Pfd.	50,000	79.75	3,937,500
	5-1 2% Pfd.	99,875	80.00	7,990,000
Gaz Métropolitain**	Common	7,112,946	7.50	53,347,000
	5-1 4% Pfd.	100,000	65.00	6,500,000
	5-1 2% Pfd.	75,000	67.00	5,025,000
	'63 Warrants	380,900	3.38	1,287,400
	'66 Warrants	300,000	2.87	862,500
Great Lakes Power	Common	1,232,234	19.50	24,028,600
Inland Natural Gas	Common	2,341,625	12.25	28,684,900
	Pfd.	400,000	13.87	5,548,000
Inter-City Gas	Common	309,426	16.50	5,105,500
	6-1 4% Pfd.	125,000	16.50	2,062,500
	Warrants	88,500	5.35	473,500
International Utilities	Common	8,234,063	32.50	210,957,600
	$1.32 Cv. Pfd.	1,166,765	32.00	37,336,500
Maritime Electric	Common	300,000	18.00	5,400,000
Newfoundland Light & Power	Common	2,472,384	7.87	19,457,700
Northern & Central Gas	Common	11,494,345	17.37	162,367,200
	2nd Cv. Pfd.	300,600	28.00	8,416,800
	1st Pfd.	150,400	36.00	5,414,400
	2nd Cv. Pfd.	1,319,975	32.50	42,899,200
	Warrants	802,457	8.20	6,580,100
	$2.70 Pfd.	41,192	34.00	1,400,500
Northwestern Utilities	Pfd.	105,000	55.00	5,775,000
Nova Scotia Light & Power	Common	4,959,049	8.37	41,507,200
Union Gas	Common	15,022,930	16.00	240,366,900
	5-1 2% Pfd.	163,200	37.00	6,038,400
	6% Pfd.	90,000	47.00	4,230,000
Totals				1,450,972,600
Change in Market Value %				

*Assumed no change from previous market quotation. **Adjusted for stock split where necessary.

NOTES: (1) Where there was ownership by any utility of stock of a subsidiary, the market value of the stock owned by the parent company was deducted from the market value of the parent company's stock.

(2) NC - No Change

APPENDIX I – SCHEDULE A

OWER CO. LIMITED

) COMMON SHARES OF 15 ELECTRIC AND GAS UTILITIES

Nov. 28, 1969		Dec. 31, 1969		Jan. 30, 1970	
Change in Price from Nov. 7	Change in Total Value	Change in Price from Nov. 7	Change in Total Value	Change in Price from Nov. 7	Change in Total Value
$	$	$	$	$	$
-1.50	-7,875,000	-2.00	-10,500,000	-3.75	-19,687,500
-5.00	-200,000	NC	—	NC	—
-12.00	-1,800,000	-12.00	-1,800,000	-15.00	-2,250,000
-1.87	-1,658,100	-4.37	-3,874,800	-6.62	-5,869,900
NC	—	NC	—	-6.00	-90,000
NC	—	NC	—	-0.75	-30,000
-5.00	-250,000	-5.00	-250,000	-8.00	-400,000
-1.00	-1,780,000	-2.00	-3,560,000	-2.00	-3,560,000
NC	—	NC	—	-0.25	-68,900
-0.25	-50,000	-0.25	-50,000	-3.00	-600,000
NC	—	-1.13	-19,733,300	-2.00	-34,926,200
+3.25	+162,500	+0.25	+12,500	-4.75	-237,500
+5.00	+499,400	NC	—	-5.00	-499,400
-0.50	-3,556,400	-1.25	-8,891,200	-1.88	-13,372,300
+1.00	+100,000	-0.75	-75,000	-8.00	-800,000
-2.00	-150,000	-4.00	-300,000	-4.00*	-300,000
-0.88	-335,200	-1.28	-487,600	-1.48	-563,200
-0.62	-186,000	-0.67	-201,000	-1.07	-321,000
NC	—	-1.50	-1,848,400	-2.13	-2,624,700
-1.25	-2,927,000	-2.25	-5,268,700	-2.88	-6,743,900
-0.12	-48,000	-0.37	-148,000	-0.87	-348,000
NC	—	-0.75	-232,100	-2.00	-618,900
+0.50	+75,000	-1.00	-125,000	-1.25	-156,200
-0.60	-53,100	-1.10	-97,300	-0.60	-53,100
-4.25	-31,715,000	-5.75	-41,013,900	-7.75	-55,940,600
-6.00	-7,000,600	-7.75	-9,042,400	-8.63	-10,069,200
NC	—	-0.50	-150,000	-0.50*	-150,000
-0.62	-1,532,900	-0.37	-914,800	-0.62	-1,532,900
-2.37	-24,755,700	-4.12	-41,141,800	-3.37	-29,388,700
-4.00	-1,202,400	-5.25	-1,578,100	-5.50	-1,653,300
-2.00	-300,800	-2.00	-300,800	-1.00	-150,400
-5.50	-7,259,900	-6.00	-7,919,800	-5.50	-7,259,900
-1.45	-1,163,600	-1.90	-1,524,700	-0.75	-601,800
+1.50	+61,800	+1.00	+41,200	+2.00	+82,400
-5.00	-525,000	-4.00	-420,000	-5.00	-525,000
-0.50	-2,479,500	-1.25	-6,198,800	-1.62	-8,033,700
-0.38	-5,708,713	-1.50	-22,534,400	-2.00	-30,045,900
NC	—	NC	—	+1.00	+163,200
NC	—	NC	—	-3.25	-292,500
	-103,614,200		-190,128,200		-239,519,500
	-7.14		-13.11		-16.51

APPENDIX I — SCHEDULE B

NEWFOUNDLAND LIGHT & POWER CO. LIMITED

CHANGE IN TOTAL MARKET VALUE OF LISTED PREFERRED AND COMMON SHARES OF FIVE TELEPHONE UTILITIES

Company	Type of Security	Number of Shares	November 7, 1969 Price $	November 7, 1969 Total Value $	November 28, 1969 Change in Price from Nov. 7 $	November 28, 1969 Change in Total Value $	December 31, 1969 Change in Price from Nov. 7 $	December 31, 1969 Change in Total Value $	January 30, 1970 Change in Price from Nov. 7 $	January 30, 1970 Change in Total Value $
Bell Canada	Common	35,173,771	42.00	1,418,505,100	+2.25	+78,620,400	+2.00	+71,035,300	-1.00	-31,921,500
B.C. Telephone	Common	2,589,300	69.00	178,661,700	+1.00	+2,589,300	+3.00	+7,767,900	-4.50	-11,651,900
	4-3/8% Pfd.	60,000	57.00	3,420,000	-1.00	-60,000	+4.00	+240,000	+6.00	+360,000
	4-1/2% Pfd.	50,000	59.00	2,950,000	+0.50	+25,000	-1.00	-50,000	+0.50	+25,000
	4-3/4% Pfd.	75,000	62.00	4,650,000	+0.50	+37,500	NC	—	-2.00	-150,000
	5-3/4% Pfd.	100,000	75.50	7,550,000	+2.50	+250,000	-0.50	-50,000	-0.50	-50,000
	6% Pfd.	45,000	80.00	3,600,000	-2.00	-90,000	-4.00	-180,000	-5.00	-225,000
	6% Pfd.	10,000	95.00	950,000	NC	—	NC	—	NC	—
	4-3/4% Pfd.	75,000	61.00	4,575,000	NC	—	NC	—	-4.00	-300,000
	5.15% Pfd.	120,000	66.00	7,920,000	+2.50	+300,000	+2.00	+240,000	+2.50	+300,000
	4.84% Pfd.	800,000	16.00	12,800,000	NC	—	+0.75	+600,000	NC	—
	6.80% Pfd.	400,000	24.00	9,600,000	+0.50	+200,000	NC	—	-1.50	-600,000
Maritime Telephone & Tel.	Common	3,719,536	16.75	62,302,200	+0.12	+446,300	-0.50	-1,859,800	-1.25	-4,649,400
New Brunswick Telephone	Common	4,375,571	11.87	51,938,000	+0.13	+568,800	+0.13	+568,800	-0.37	-1,619,000
Quebec Telephone	Common	1,741,067	13.75	23,939,700	NC	—	-0.75	-1,305,800	-1.88	-3,273,200
	5% Pfd.	13,835	20.00	276,700	NC	—	NC	—	NC	—
	5% Pfd.	5,254	20.25	106,400	NC	—	-0.25	-1,300	-0.25	-1,300
	5% Pfd.	64,318	14.00	900,500	NC	—	NC	—	+2.25	+144,700
	5% Pfd.	40,557	14.00	567,800	NC	—	+1.00	+40,600	+1.00	+40,600
	4-3/4% Pfd.	400,000	12.00	4,800,000	NC	—	-0.75	-300,000	NC	—
	6.2% Cv. Pfd.	290,178	15.00	4,352,700	+0.25	+72,500	+0.25	+72,500	+0.25	+72,500
Totals				1,804,365,800		+82,960,800		+76,818,200		-53,498,500
Change in Market Value %						+4.60		+4.26		-2.96

NOTE: (1) Where there was ownership by any utility of stock of a subsidiary, the market value of the stock owned by the parent company was deducted from the market value of the parent company's stock.

(2) NC — No Change

APPENDIX II

NEWFOUNDLAND LIGHT & POWER CO. LIMITED

COMPARISON OF FEDERAL BENEFITS FROM UTILITY TAXATION UNDER WHITE PAPER PROPOSALS AND UNDER CONDITIONS APPLICABLE TO WIDELY-HELD CORPORATIONS WITH CONTINUATION OF EXISTING TAX TRANSFER ARRANGEMENTS

Federal Benefits from	(A) Under White Paper Proposals	(B) Under Conditions for Widely-held Corporations and continuation of provisions of P.U.I.T.T. Act	(C) Difference
Corporate Taxes	–	$ 409,000(1)	$ 409,000
Shareholder Taxes(2)	$ 456,000(3)	101,000(4)	355,000
Total	$ 456,000	510,000	54,000

NOTES:

(1) Federal benefits from corporate taxes based on taxes paid in 1969 ($1,742,580) with the distribution of tax as shown in Appendix II, Schedule A.

Retention of 5% of Federal Tax – .05 x 1,211,000	=	$ 60,000
Old Age Security Tax	=	100,000
Interest benefit from retention of 95% of Federal Tax for 3 years at 8-1/2 per cent = .217 x .95 x 1,211,000	=	249,000
Total		$ 409,000

(2) Federal share of shareholder taxes based on dividends paid in 1969 ($1,542,800) adjusted to exclude portion of dividends not eligible for tax credit as shown in Appendix II, Schedule B. Eligible dividends = .947 x $1,542,800 = $1,461,000. Federal benefits from taxation of non-eligible dividends would be common to the two cases (A) and (B) shown above. The Federal share of shareholder taxes of 78%

(3) Federal share of taxes from eligible dividends under the White Paper Proposals for public utilities – see Appendix II, Schedule C for determination of the estimated marginal tax rate of Newfoundland Light shareholder.
(0.781 x $1,461,000 x .40 = $456,000)

(4) As for (3) but including full gross-up of dividends.
(0.781 ($1,461,000 x 1.5 x .40 -.8 x 1,461,000) = $101,000)

Based on Federal corporation tax abatement of 10% of taxable income and an overall tax rate of 50%.

APPENDIX II

SCHEDULE A

NEWFOUNDLAND LIGHT & POWER CO. LIMITED

FEDERAL AND PROVINCIAL GOVERNMENT SHARES OF CORPORATE TAXES 1969

Tax	Tax Rate (per cent of taxable income)	Distribution of Total Tax Paid in 1969 ($000)
Basic Federal Tax	45	1500
Surtax (3% of 45%)	1.35	45
Old Age Security Tax	3	100
Sub-Total	49.35	1645
Less: Provincial Tax Abatement	(10)	(334)
Add: Provincial Tax	13	432
Total	52.35	1743

Summary

		($000)
Federal Tax = 1500 + 45 − 334	=	1211[(1)]
Old Age Security Tax	=	100
Provincial Tax	=	432
Total		1743

NOTE:

(1) Under the terms of the Public Utilities Income Tax Transfer Act, 95% of Federal Tax = .95 X 1,211,000 = $1,150,000 payable to the Province in 1972

APPENDIX II
SCHEDULE B

NEWFOUNDLAND LIGHT & POWER CO. LIMITED

ESTIMATE OF PROPORTION OF DIVIDENDS ELIGIBLE FOR TAX CREDIT

Classification of Newfoundland Light Shareholders(1)	Proportion of Common and Preferred Shareholdings
Eligible for tax credit:	
Individuals	74.1
Closely-held companies	10.4
Widely-held companies (2)	4.5
Mutual funds and insurance companies (2)	5.3
Unclassified shareholders	0.4
	94.7
Not eligible for tax credit:	
Non-residents	1.3
Pension funds	0.5
Non-taxable organizations	3.5
	5.3
Total	100.0

NOTES:

(1) The classification of Newfoundland Light shareholders was based on a review of the current shareholders list, with direct contact with shareholders where the classification was in doubt.

(2) It is assumed that all dividends paid to widely-held companies, mutual funds and insurance companies, will ultimately flow through to their individual shareholders who will receive in effect the benefit of the tax credit. No adjustment has been made for the non-resident and pension fund portion of these ultimate holdings.

APPENDIX II
SCHEDULE C

NEWFOUNDLAND LIGHT & POWER CO. LIMITED

ESTIMATE OF MARGINAL
TAX RATE OF INDIVIDUAL CANADIAN INVESTOR

SCHEDULE OF RATES PROPOSED IN "PROPOSALS FOR TAX REFORM – 1969"

(1) Taxable Income Bracket[1]	(2) Income Bracket[2]	(3) Total 1967 Dividend Income[3]	(4) Combined Federal and 28% Provincial Tax Rate on Income in Bracket[1]	(5) Marginal Tax on 1967 Dividend Income (3) x (4)
$	$	($000)	%	($000)
		11,292	0.0	0.0
0 – 500	Under 3,500	36,934	21.76	8,037
500 – 1,000	3,500 – 4,000	10,579	23.04	2,437
1,000 – 1,500	4,000 – 4,500	10,655	24.32	2,591
1,500 – 2,000	4,500 – 5,000	12,019	25.60	3,077
2,000 – 3,000	5,000 – 6,000	22,988	26.88	6,179
3,000 – 4,000	6,000 – 7,000	21,781	28.16	6,134
4,000 – 5,000	7,000 – 8,000	22,401	30.72	6,882
5,000 – 7,000	8,000 – 10,000	40,389	33.28	13,441
7,000 – 10,000	10,000 – 13,000	54,339	35.84	19,475
10,000 – 13,000	13,000 – 16,000	45,969	38.40	17,652
13,000 – 16,000	16,000 – 19,000	36,465	42.24	15,445
16,000 – 24,000	19,000 – 27,000	64,129	46.08	29,551
24,000 – –	27,000 – –	210,828	51.20	107,944
		600,768	39.80	238,845

Use Rounded Value of Marginal Tax Rate of 40%

[1]Source: Table 2, p. 25, "Proposals for Tax Reform – 1969"

[2]Assuming tax exemptions of married taxpayer with no dependents, including portion of employment deduction, i.e. ($3,000).

[3]Source: 1969 Taxation Statistics analyzing 1967 tax returns for individuals. Where the data was not in sufficient detail to report by the above brackets, it was pro-rated on an equal basis.

APPENDIX III

NEWFOUNDLAND LIGHT & POWER CO. LIMITED

ESTIMATED INCREASE IN REVENUE REQUIREMENT TO PROVIDE SHAREHOLDERS WITH AFTER-TAX INCOME SIMILAR TO OTHER WIDELY-HELD CORPORATIONS

	Revenue Required for Dividends & Taxes	Total Tax Paid	Shareholder After-Tax Income
		($000)	
Revenue Requirement if Taxed as a Widely-Held Corporation (1)			
Dividends	1,543	154 (2)	1,389
Taxes	1,743	1,743	–
Total	3,286	1,897	1,389
Revenue Requirement if Taxed as Proposed in the White Paper, but to Provide Similar After-Tax Return as for a Widely-Held Corporation			
Dividends	2,315	926 (3)	1,389
Taxes	2,515 (4)	2,515	–
Total	4,830	3,441	1,389
Increase in Revenue Requirement	1,544		
Increase in Taxes on Dividends		772	
Increase in Taxes on Corporate Taxable Income		772	
Total Increase in Taxes/Revenue Requirement	1,544	1,544	

NOTES:

(1) 1969 Dividends and taxes paid.

(2) Shareholder taxes based on average marginal tax rate as given in Appendix II, Schedule C, with full grossing-up of dividends.

(3) Shareholder taxes based on average marginal tax rate as given in Appendix II, Schedule C, with no grossing-up of dividends.

(4) Corporate taxes increased to reflect the increment in dividends, based on an assumed corporation tax rate of 50 per cent.

COMPARISON OF FEDERAL BENEFITS FROM UTILITY TAXATION UNDER WHITE PAPER PROPOSALS AND UNDER CONDITIONS APPLICABLE TO WIDELY-HELD CORPORATIONS WITH CONTINUATION OF EXISTING TAX TRANSFER ARRANGEMENTS

1967

Federal Benefits from	Under White Paper Proposals	Under Conditions for Widely-held Corporations and Continuation of Provisions of P.U.I.T.T. Act	Difference
	(millions of $)		
Corporate Taxes (1)*	- (2)	9.9 (3)	9.9
Shareholder Taxes (4)	13.2 (5)	6.6 (6)	(6.6)
Total	13.2	16.5	3.3

* See attached notes.

Sources of Data

- D.B.S. Corporation Taxation Statistics, 1967.
- Department of National Revenue, Taxation Statistics, 1969, covering the 1967 taxation year.
- Minister of Finance, Proposals for Tax Reform, 1969.
- Royal Commission on Taxation.

NOTES

(1) Corporate taxes paid in 1967:

Number of Corporations	Classification	Federal Taxes Payable	Provincial Taxes Payable	Total
		($ million)		
57	Electric Utilities	16.6	4.6	21.2
44	Gas Distribution Utilities	14.8	4.2	19.0
166	Other Utilities	0.2	0.1	0.3
		31.6	8.9	40.5

Source: D.B.S. Corporation Taxation Statistics, 1967.

(2) Under the proposals contained in the White Paper it is assumed that 100% of corporate taxes will be subject to immediate transfer to the provinces.

(3) Federal benefits from corporate taxes are based on the following:

(i) Tax Rates

		Proportion of Taxable Income (%)
Basic Corporate Tax Rate	-	45
Surtax (3% of 45%)	-	1.35
Old Age Security Tax	-	3
Sub-total	-	49.35
Less Provincial Tax Abatement	-	(10)
Plus Provincial Tax (average value of 11% assumed)	-	11
Total	-	50.35

(3) (ii) Federal Benefits

The federal benefits from corporate taxes are based on the above rates and the provisions of the Public Utilities Income Tax Transfer Act.

			($ million)
Old Age Security Tax -	$\frac{3\% \times 100}{50.35} \times \$40.5$ million	=	2.4
Retention of 5% of Federal Tax -	$\frac{5\% \times 36.35}{50.35} \times \$40.5$ million	=	1.5
Benefit from retaining 95% of Federal Tax for 3 years @ 8½% -	$.217 \times \frac{95\% \times 36.35}{50.35} \times \$40.5$ million	=	6.0
	Total	=	9.9

(4) Shareholder Taxes

(i) Dividends paid by utilities, 1967:

Number of Corporations	Classification	Dividends Paid ($ million)
57	Electric Utilities	21.9
44	Gas Distribution Utilities	29.4
166	Other Utilities	-
		51.3

Source: D.B.S. Corporation Taxation Statistics, 1967.

(4) (ii) Proportion of dividends eligible for tax credits:

Based on the distribution of share ownership between resident and non-resident shareholders contained in Table 37.3, Volume 6, Royal Commission on Taxation, the proportion of resident ownership =

$$\frac{160}{239} \times 100 = 67\%.$$

In the analysis it has been assumed that 67% of dividends are eligible for tax credit provisions. This does not take account of shares owned by pension funds or other non-taxable institutions.

			($ million)
Dividends eligible for tax credits	.67 x $51.3 million	=	34.4
Dividends paid to non-residents	.33 x $51.3 million	=	16.9
	Total	=	51.3

(5) Federal revenue from personal taxes on dividend income:

			($ million)
Residents*	$34.4 million x .40 x .78	=	10.7
Non-Residents**	$16.9 million x .15	=	2.5
			13.2

* See attached Schedule 'A' for estimated proposed marginal tax rate for shareholders. Federal share of 78 per cent is based on $\frac{100}{128}$ of total tax.

** Withholding tax of 15 per cent assumed to accrue entirely to the Federal revenues.

(6)

($ million)

Federal revenues from personal taxes on dividend income using tax credit provisions applicable to widely-held corporations -

Residents -		
.78 x $34.4 million x 1.395* x .40 - .80** x $34.4 million x .395*	=	4.1
Non-Residents -		
$16.9 million x .15	=	2.5
		6.6

* Gross-up and tax credit reduced from 50% of dividends to 39.5% since corporate taxes amount to only 79% $\frac{(40.5)}{(51.3)}$ of dividends paid in 1967.

** Federal share of tax credit based on continuation of federal corporation tax abatement of 10 per cent of taxable income and a uniform national tax rate of 50 per cent of taxable income.

SCHEDULE 'A'

ESTIMATE OF MARGINAL

TAX RATE OF INDIVIDUAL CANADIAN INVESTOR

SCHEDULE OF RATES PROPOSED IN "PROPOSALS FOR TAX REFORM - 1969"

(1) Taxable Income Bracket[1] $	(2) Income Bracket[2] $	(3) Total 1967 Dividend Income[3] $ '000	(4) Combined Federal and 28% Provincial Tax Rate on Income in Bracket[1] %	(5) Marginal Tax on 1967 Dividend Income (3 x 4) $ '000
		11,292	0.0	0
0 - 500	Under 3,500	36,934	21.76	8,037
500 - 1,000	3,500 - 4,000	10,579	23.04	2,473
1,000 - 1,500	4,000 - 4,500	10,655	24.32	2,591
1,500 - 2,000	4,500 - 5,000	12,019	25.60	3,077
2,000 - 3,000	5,000 - 6,000	22,988	26.88	6,179
3,000 - 4,000	6,000 - 7,000	21,781	28.16	6,134
4,000 - 5,000	7,000 - 8,000	22,401	30.72	6,882
5,000 - 7,000	8,000 - 10,000	40,389	33.28	13,441
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24,000 - --	27,000 - --	210,828	51.20	107,944
		600,768	39.8	238,845

Use Rounded Value of Marginal Tax Rate of 40%

1 Source - Table 2, p. 25, "Proposals for Tax Reform - 1969".

2 Assuming tax exemptions of married taxpayer with no dependents, including portion of employment deduction, i.e. ($3,000).

3 Source - 1969 Taxation Statistics analyzing 1967 tax returns for individuals. Where the data was not in sufficient detail to report by the above brackets, it was prorated on an equal basis.

PROVINCE OF NEWFOUNDLAND

Board of Commissioners of Public Utilities

Administrators of: The Public Utilities Act, The Public Utilities (Acquisition of Lands) Act, Motor Carrier Act, Ferries Act

P. O. BOX 5427
ST. JOHN'S

January 13th, 1970.

HONOURABLE MINISTER OF JUSTICE.

The White Paper Proposals 4.63 to 4.65 are exepcted to have a material affect on the cost of money to electric utilities. The Board requested Peat, Marwick, Mitchell & Co. to review the proposals and we have set forth below for your consideration the various comments submitted by them.

PRESENT TAX TREATMENT:

These utilities pay taxes at rates which are slightly lower than other companies, but this differential is not significant. The Federal Government refunds to the Provincial Government 95% of all federal taxes, excluding Old Age Security Tax, together with 100% of the provincial taxes collected. The 5% is retained to offset the 20% tax credit which the shareholders of these companies can now claim when calculating their personal income tax.

The Public Utilities Income Tax Transfer Act of 1966 was enacted by the Parliament of Canada to authorize the Minister of Finance to transfer to the provinces a proportion of the income tax payable by certain public utility companies. The Act clearly states that the minister "may" pay to a province .... at such time as he may determine and that where the province certifies that "an amount that is all or part of an amount paid to it under this Act has been paid or otherwise transferred or credited to a designated corporation for its own use and benefit .... the amount so certified is exempt from income tax."

PRESENT TAX TREATMENT (Cont'd)

It would, therefore, appear that Parliament envisaged a direct rebate by the provinces to the electric utilities of the amount of the tax so that the charges to the utilities' customers would not be influenced by Federal Government taxation. In respect of federal taxes, they would be in almost the same position as customers of provincially-owned utilities.

PROPOSED TAX TREATMENT:

The White Paper proposes that taxes of electric and certain other utilities of which 95% is presently being transferred to the provinces, under the Public Utilities Income Tax Transfer Act of 1966, will now be paid in full to the provinces. Together with this proposal is another which removes these utility companies from the general proposals for widely held corporations and specifically disallows their shareholders any form of tax credit on dividends for calculation of personal federal income taxes.

RESULTS OF IMPLEMENTATION OF WHITE PAPER PROPOSALS:

1. Private Electric Utility Customers' Consideration:

(a) If the proposals are enacted, we feel that the electric utilities will be provided with grounds for application to their regulatory authority to obtain increases in the rates which they charge customers in order to attract investment in shares of these companies. Alternatively, the electric utilities would have to resort to larger debt financing in order to meet their fiscal requirements and at a time when interest rates are high and the bond market overtaxed. Any increase in borrowings would also impair their debt ratio, thereby further increasing the cost of future borrowings. This would also lead to needs for increased allowable rates of return for these electric utilities.

(b) "The report of the Royal Commission on Taxation" discusses investor owned public utilities in Volume 4, p.p 126-128 and recommends that they be treated the same as other canadian corporations. There was no recommendation made with respect to the amount turned over to the provinces by the Federal Government because it was outside the terms of reference of the Commission. However, it is noted that under their proposals "this would represent moneys which had also been credited by the Federal Government to resident shareholders". Thus, it appears that the Commission felt that an arrangement which had been made by the Federal Government

Private Electric Utility Customers' Consideration:

for the transfer of funds to a province which might, or might not, benefit consumers should not affect the shareholders of the utility.

(c) However, such a rebate would operate to increase the rate of return of the utility and thus the eventual benefit may accrue to the consumer and not the shareholder since the rate of return is governed by the regulatory bodies. At the present time the shareholder does receive the dividend tax credit applicable to dividends from canadian taxable corporations and thus are treated in the same manner as the holders of shares of other taxable canadian corporations.

2. Private Electric Utility Shareholders' Considerations:

(a) The proposal to withdraw the "gross-up" and "tax credit" concept from these shares appears discriminatory because the taxes paid by the utilities which are rebated to the provinces would not benefit the shareholders when calculating their proposed taxes. It is our feeling that the shareholders of the utilities whose taxes are rebated under the Public Utilities Income Tax Transfer Act should be treated no differently than those of other canadian corporations whose taxes flow to the Federal Treasury and are returned to the provinces under other fiscal arrangements between the two levels of government.

(b) The shareholder's rate of return on electric utilities is largely fixed by regulatory bodies and thus the shares of such companies are generally purchased by tax payers who wish a reasonably stable income with some capital appreciation. Certainly, the present dividend tax credit was a consideration of investors when deciding to invest in shares of these companies and this would be reflected in the price for the shares. In fact, the uncertainty about the status of income from shares of electric utilities has already had a marked detrimental effect on their share values on the exchanges.

3. Provincial Government Consideration:

(a) The taxing of dividend income in the hands of the shareholders of the investor owned electric utilities with no dividend tax credit will have the effect of increasing the Federal Government tax on the earnings of the shareholders of these utilities at the expense of the provincial governments and/or the customers of the utilities.

Provincial Government Consideration (Cont'd)

(b) The earnings of the investor owned electric utilities is determined by provincial regulatory commissions who include in their deliberations the concept of a "fair return" to shareholders. This "fair return" may be defined as the net-of-tax dividend. If the proposals were implemented it would follow that the regulatory bodies would have to alter the regulatory processes which have been used historically to allow for the reduction in the after tax return to the shareholders of these utilities.

(c) The transfer to the provinces of the tax receipt and the responsibility for compensating the utility companies' customers for rate increases associated with this transfer seems to indicate that the Federal Government is proposing to renege on its stated policy of equal treatment to publicly and investor owned electric utility customers, which is now possible under the Public Utilities Income Tax Transfer Act.

(d) It would appear that provinces which have not presently taken over the investor owned electric utilities in their provinces are being invited to do so. A commitment of funds by the Government of Newfoundland & Labrador for such a purchase would require the province to make use of part of its ability to borrow the same amount of funds to provide basic service needs; e.g., roads, hospitals, schools, etc. This would, therefore, slow down the rate at which these public services would be obtained. Furthermore some shareholders would probably move their investments out of the Province. This would not be desirable.

GENERAL:

Among the other possible effects of the implementation of the proposals would appear to be the probability that if earnings on equity are substantially increased, these investments would become very attractive from the U.S. investors point of view. This could well lead to the investor owned electric utilities in Canada being taken over by American interests.

CONCLUSION:

For the foregoing reasons we believe that the implementation of the White Paper Proposals relating to electric utilities are discriminatory and possibly confiscatory. Therefore, we suggest that this Province should recommend to the Federal Government that the proposals contained in paragraph 4.63 to 4.65 be withdrawn and that electric utility companies be treated in the same way as other canadian corporations. Newfoundland Light & Power Co. Limited have already submitted a like recommendation to the Honourable Minister of Finance, a copy is attached.

It is probable that the Department of Finance will be submitting a brief or making representation to the Chairman of the House of Commons Committee on Finance, Trade and Economic Affairs relating to other proposals contained in the White Paper. If so the foregoing can be incorporated in the Provincial submission.

I understand that Mr. Gaston Clermont, M.P. (Gatineau) has set a deadline of March 1st, 1970 for the receipt of briefs but notice of the intention to submit briefs should be given to Miss Dorothy F. Ballantine, Clerk of the Committee, House of Commons, Ottawa, not later than Monday, January 19th, 1970.

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C. W. Powell,
Chairman.

APPENDIX F

MARITIME ELECTRIC COMPANY, LIMITED

SUBMISSION TO THE

STANDING COMMITTEE

ON BANKING, TRADE AND COMMERCE

OF THE SENATE

ON

PROPOSALS FOR TAX REFORM, 1969

March 1970

MARITIME ELECTRIC COMPANY, LIMITED SUBMISSION ON PROPOSALS FOR TAX REFORM

SUMMARY

This submission is made on behalf of Maritime Electric Company, Limited and its electricity customers in Prince Edward Island. It is concerned with the effect of paragraphs 4.63 to 4.65 of the Government's White Paper on Tax Reform, which would deny dividend tax credits to the shareholders of certain public utilities on the grounds that the Federal Government proposes to transfer to the provinces amounts equal to the corporation taxes paid by these utilities.

The announcement of these provisions of the White Paper has already increased the cost of capital to the investor-owned electric and gas utilities and affected their ability to raise adequate amounts of money for the expansion of their systems to meet their customers' needs. In Prince Edward Island this means a possible increase in the price of electricity, in the face of a need to hold the price at the lowest possible level, and inhibition of expansion of electrical services, in the face of a need to expand the economic base of the Province.

The expectation of what amounts to double taxation of the shareholders of these public utilities has led to a drop in the share values of the utilities affected, relative to share values in other industries, of over 200 million dollars. The majority of the shareholders of Maritime Electric live in the Atlantic Provinces and have relatively small holdings of shares.

This submission contends that the Federal Government's disposition of moneys to the provincial governments should have no bearing on the administration of tax collection. It presents estimates to show that the provisions contained in paragraph 4.63 to 4.65 can be deleted from the White Paper without cost to the Federal Government.

ELECTRIC SERVICE NEEDS OF PRINCE EDWARD ISLAND

Maritime Electric Company, Limited provides 97 % of the electric energy requirements of the 109,000 people of Prince Edward Island. The Company's service rates are regulated by the Public Utilities Commission of the Province on the basis of cost of service plus return on a rate base determined by the Commission. The Company has a gross investment of $26,731,000 in its fixed assets directed to the service of the public of the Province.

The public utility industry is capital intensive in the highest degree. It has been calculated from Federal Government statistics [1] that in 1964 the electric utility companies of Canada employed $5.22 of investment per dollar of gross revenue as compared with $4.44 per dollar of gross revenue in the telephone companies, $0.76 per dollar of gross revenue in manufacturing and $0.19 per dollar of gross revenue in retail trade. In 1969, costs which were a function of capital, such as return, depreciation, income taxes and other taxes, amounted to over one-half of Maritime Electric's cost of providing electric service. The industry is also characterized by its need to raise large amounts of capital each year to provide facilities to cater for the growing electrical needs of industry and the public. Maritime Electric's sales of electricity in Prince Edward Island have grown at an average rate of 12% per year over the five years 1965 to 1969. In order to meet this requirement the Company has invested in Prince Edward Island an average of $2,119,000 annually over the same period.

The need for expansion of the economy of Prince Edward Island, in order to provide employment and an improved standard of living for its people, has been recognized by the adoption of the Federal-Provincial Comprehensive Development Plan. If the objects of the Plan are to be met, it is essential that the Company, which has been charged with meeting the increased requirements of industry and the public for electric service, be able to raise the capital necessary for the provision of generators, power lines and other equipment.

The distribution of the population of the Province, typical of a predominantly agricultural area, and the isolation of its electrical system from others, presents a difficult problem in serving the electrical needs of its people at reasonable cost. The Provincial Government and the Company have cooperated for many years in a Rural Electrification Plan which has resulted in the extension of service to an estimated

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[1] Department of National Revenue, Taxation Division, "1966 Taxation Statistics, Part Two, Corporations – 1964", (publication discontinued with 1964 data)

90% of the occupied farms in the Province. Since 1951, electric service rates have been progressively reduced and to date increases in costs have been contained without rate increases. Notwithstanding these efforts, and principally because of the distribution of customers and the size of the system, electric rates are relatively high in the Province as may be shown by the following typical estimated monthly bills for consumers in Charlottetown (whose rates reflect a degree of subsidy to rural users) and other cities in the Atlantic Provinces and the eastern United States.

TABLE I

Typical Estimated Monthly Bills for Residential Consumption of 350 Kilowatt-hours

Charlottetown	\$9.65 [1]
St. John's, Nfld.	7.65 [1]
Fredericton, N.B.	7.90 [1]
Halifax, N.S.	8.30 [1]
Boston, Mass.	12.11 [2]
Bangor, Me.	10.20 [2]
New York City	12.33 [2]

In order to meet the needs of the people of Prince Edward Island for a healthy and growing industrial and agricultural base and for an improved standard of living, it is imperative to maintain electric power rates at the lowest possible level. Any measure which would tend to raise the cost of electricity would tend to frustrate these reasonable and necessary needs.

THE PUBLIC UTILITIES INCOME TAX TRANSFER ACT AND THE WHITE PAPER ON TAXATION REFORM

Under the Public Utilities Income Tax Transfer Act of 1966, amounts based on 95% of the Federal Government's portion of Maritime Electric Company, Limited's corporation taxes (exclusive of the Old Age Security Tax) are returned to the Provincial Government. Although the reasons are not clear, the taxes to be so transferred are retained by the Federal Government for three years before the rebate is made, apparently for administrative purposes.

[1]Rate Book, Canadian Electrical Association

[2]Rate Book, Edison Electric Institute 1967

Before the passing of the Public Utilities Income Tax Transfer Act and after 1947, 50 % of the Federal Government's portion of corporation taxes paid by electric and gas utilities, less certain provincial taxes, was returned to the provinces in which the utilities were located in order to reduce the differential in the cost of electricity and gas resulting from the payment of income tax by the investor-owned utilities but not by tax-exempt government-owned utilities. This purpose has been accomplished more fully since the passing of the Public Utilities Income Tax Transfer Act, which has proved to be an equitable and satisfactory arrangement.

The Federal Government's White Paper on Taxation Reform proposes a partial integration of the taxes paid by widely-held corporations with the taxes paid by their shareholders. The method proposed would give the Canadian shareholder credit for one-half of the tax paid by the corporation on the profits from which the dividend is paid.

This submission is concerned only with the effects of paragraphs 4.63 to 4.65 of the White Paper. In these paragraphs the Government proposes that, in place of the transfer to the provinces of 95% of the public utilities' corporation taxes, 100% of these taxes would be rebated to the provincial governments. This part of the White Paper postulates that since, under these arrangements, no part of these taxes would be retained by the Federal Government, the shareholders concerned would be given no credit on the income taxes payable on their dividends, for the taxes paid by these corporations.

In effect, the Canadian shareholders of public utility companies will thus be subject to double taxation. The shareholders of no other Canadian companies will be taxed personally at the full rate on income on which corporation taxes have already been paid.

CONSEQUENCES OF WHITE PAPER

Before the publication of the White Paper, the public utilities were having difficulty in attracting the capital needed for their expansion. Under inflationary conditions long-term bonds have fallen into disfavour with investors. This difficulty may be overcome by the sale of bonds to which are attached warrants for the purchase of common shares or with which is associated the right of conversion into common shares. Now the White Paper has prejudiced the sale of common shares, and this recourse is also all but removed for the public utility seeking capital. The deterioration of the position of public utility stock in the eyes of the investor is demonstrated in Table II following, showing the trends in electric and gas utility stock values in comparison with those of other industries since the publication of the White Paper.

TABLE II.

Change in Total Market Value of 15 Major Electric & Gas Utilities

(Total Market Value on November 7, 1969 = $1,451 million)

	November 7, 1969, to		
	Nov. 30, 1969	Dec. 31, 1969	Jan. 30, 1970
1. Percentage change in Toronto Stock Exchange Industrial Index	+3.73 %	+3.02 %	− 1.66 %
2. Percentage change in aggregate value of the equities of the 15 utilities	− 7.14 %	−13.11%	−16.51 %
3. Relative percentage change of value of utilities (Item 2. minus Item 1.)	−10.87 %	−16.13 %	−14.85 %
4. Actual drop in value of 15 utilities ($ million) (Item 2. x $1,451 million)	104	190	240
5. Relative drop in value of 15 utilities ($ million) (Item 3. x $1,451 million)	158	234	215

It seems inevitable that, under the conditions imposed on public utility investors by the White Paper, common share prices will decline to a point such that the shareholders' yield after taxes will approximate the yield available after taxes of comparable widely-held corporations. Alternatively, if utility shares are to recover their lost values, the revenues of the public utilities will have to be increased to the point that large enough dividends can be paid to provide the shareholder with a return after taxes somewhat better than that which he could receive from bonds. In either case, the cost of capital to the electric and gas utilities will be seriously increased.

It follows that, if the proposals of paragraphs 4.63 to 4.65 of the White Paper are not modified, the utilities will have no way out but to increase service rates substantially. The magnitude of the rate increases necessary may be judged from the knowledge that the cost of capital is one of the principal costs involved in the production and distribution of these services. In Prince Edward Island electric power rates are regulated on the basis of cost, and an increase in such a basic element of

cost is bound to be reflected in substantial rate increases. The effects of such rate increases would be felt in every sector of provincial life. Increases in industrial rates would lower the competitiveness of P.E.I. industries and deter the attraction of new industries in which power is an important component of product cost. Increases in rates for farm service would increase the cost of this essential service to the farmer. Since electricity is now also one of the essential services in the home, an increase in its cost tends to bear most heavily on the lower and fixed income groups.

The consequences of the Company's being unable to raise adequate amounts of money in the capital markets would be equally severe. Delays in meeting the electric service requirements of industry, deterioration of the quality of service and disruptions of service would all result from the failure of investment to keep pace with growth.

MAGNITUDE OF THE PROBLEM

Maritime Electric's invested capital, as at December 31, 1968, consisted of $9,350,000 in First Mortgage Bonds; $750,000 in Preferred Stock; and Common Equity, including retained earnings, of $6,528,000. The latest long-term financing undertaken by the Company consisted of $2,500,000 in 7-3/4 % First Mortgage Bonds which were sold in 1967. From 1967 to the present, the Company has been able to meet its capital needs from current cash flows, sales of assets and bank loans. However, as planned additions are made to its generating plant and transmission and distribution system, it will need to seek capital in the Canadian money markets in the not distant future.

In 1968 Maritime Electric accrued $486,934 [1] in corporation taxes for payment to the Federal Government. Of this amount approximately $99,000 [1] is collected on behalf of the Government of Prince Edward Island. Under the Public Utilities Income Tax Transfer Act, the Federal Government will return to P.E.I. in 1971 an estimated $340,000. If the recommendations of the White Paper were enacted, the total amount returned to P.E.I. would be increased to about $490,000 due to increased rates of taxation and the return of 100% of the tax.

In addition, based on 1968 income and full rates of taxation without credit for corporation taxes paid, as proposed in the White Paper, it is estimated that shareholders of Maritime Electric would pay to the Federal Government income taxes of $146,000 [2]. If these shareholders were afforded the same dividend tax credits as the shareholders of other widely-held companies, it is estimated that their taxes on these dividends would amount to $37,000 [2]. This difference makes it quite

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[1] Appendix I.

[2] Appendix II.

plain why the shares of electric and gas public utility companies have lost favour with investors since the publication of the White Paper.

The common stock shareholders of Maritime Electric Company, Limited, who would be subject to this additional taxation under the recommendations of the White Paper, are a group of whom 74 % live in the Atlantic Provinces and have an average holding of 154 shares of common stock. The provisions of the White Paper in respect to utility shareholders are hard on small shareholders, most of whom have limited means. Under White Paper conditions, a shareholder in Maritime Electric in the 30 % tax bracket and holding 100 common shares would pay a tax of $34.50 on his 1968 dividends while, if he owned shares in a telephone company, he would pay no tax at all.

If the recommendations of the White Paper in respect of the taxes of shareholders in gas and electric utilities are made law, companies such as Maritime Electric Company, Limited will have to raise their dividends in order to attract capital on a comparable basis with other widely-held corporations. The only way for this to be accomplished will be for Maritime Electric to apply to the Public Utilities Commission of Prince Edward Island for an increase in rates. The Chairman of the Public Utilities Commission, in a letter to the Provincial Treasurer dated February 19th, 1970, has acknowledged that an increase in electric rates will be necessary if paragraphs 4.63 to 4.65 of the White Paper are implemented.

A calculation of the increase in revenue required by Maritime Electric over the 1968 level in order to meet the investor's expectations is given in Appendix II. It is significant to note that, of the whole amount of $382,000 required as an increase in revenue, 98 % ends up in the hands of either federal or provincial governments: $191,000 as an increase in corporation taxes and $182,000 as an increase in income taxes on dividends.

ALTERNATIVE SUGGESTED IN WHITE PAPER

It has been suggested in the White Paper that, since an amount equal to the whole of the corporation taxes paid by electric and gas utilities is to be returned to the provinces in which their operations are located, respectively, the removal of the disability under which these utilities and their shareholders have been placed is a provincial matter. Apart from the obvious geographical and political impracticalities of each provincial government compensating shareholders in any of the provinces, or of a provincial government making payments to a company for the benefit of its shareholders, the problem of uniform treatment of utilities and their shareholders by all of the provinces seems insurmountable. The provinces which are currently receiving rebates of utility taxes from the Federal Government have committed the funds in a variety of ways, in some cases transferring them to the utility customers

or to the municipalities in which the taxes originated, but in no case to utility shareholders. In the case of Prince Edward Island, the Province has made no commitment to return corporation tax rebates to Maritime Electric Company, Limited, its shareholders or its customers. The rebates are already earmarked for other essential provincial purposes. Altogether, the suggestion of the White Paper that the utilities should deal with the provinces in the matter of compensation of their shareholders for the loss of dividend tax credits places the utilities unfairly in the position of involvement in federal-provincial fiscal discussions.

IMPLICATIONS OF PARAGRAPHS 4.63 TO 4.65

It is not the intention of the Company to question the principles underlying the drafting of the White Paper. It is apparent that the principle of granting income tax credits on dividend income of Canadian shareholders for corporation taxes paid by companies operating in Canada will have positive economic results. A second principle implicit in the White Paper seems to be that credit is given only for, and is limited by the extent of, taxes actually paid. For instance, a shareholder of a company whose corporate taxes are reduced by abnormally high capital cost allowances will be entitled to a lesser credit than that which would be allowed on the same dividend payment to a shareholder in a like company whose taxes are at the normal level. This principle is seemingly extended to form the basis of the contention in paragraphs 4.63 to 4.65 that since, under the proposed transfer of 100 % of utility tax payments to the provinces, the Federal Government retains no part of these taxes, it should not be obliged to allow the utility shareholders the same reduction in tax rates allowed to shareholders of other companies on account of corporation taxes paid.

Not only does this inference carry consistency to the point of impracticality, but the inference itself is invalid because, in the case of the electric and gas utilities, and from their point of view and that of their shareholders, corporation tax has been paid. Under the White Paper proposals, these utilities pay corporation taxes at exactly the same rates as do other companies.

The fact that the Federal Government transfers funds to the provinces under legislation and federal-provincial agreements for purposes of convenience in collection, revenue equalization, shared programmes, grants-in-aid or equalization of electricity and gas rates is no reason to place the electric and gas utilities and their shareholders under a major disability. Actually, transfers under the Public Utilities Income Tax Transfer Act are made out of the Consolidated Revenue Fund, and, while calculated as functions of the amounts of corporation taxes paid, are no more

charges against the corporation taxes of these utilities than against other sources of federal revenue. The Royal Commission on Taxation mentioned the need for transfer payments based on utility corporation taxes in order to provide for competitive equality between investor-owned utilities and tax-exempt government-owned public utilities. It also recognized that the solution of problems of comparable taxation lay outside of its terms of reference since transfer payments are a matter of expenditure, not of taxation.

RECOMMENDATION

Government spokesmen have emphasized that the White Paper on Taxation Reform is a proposal, that it should be the subject of the widest possible debate and that the government will give consideration to any relevant facts brought to its attention in the preparation of the necessary legislation. This submission is offered in the earnest belief that there are facts which should be brought to light bearing on the taxation of electric and gas utilities and of their shareholders and in the hope that its recommendation will lead constructively to equity in this field of taxation.

This submission recommends that the measures proposed in paragraphs 4.63 to 4.65 of the Proposals for Tax Reform be not committed to legislation and that the present provisions of the Public Utilities Income Tax Transfer Act be retained in force.

It is submitted that, as a result of continuing the transfers to the provinces provided by the Public Utilities Income Tax Transfer Act and allowing to the shareholders of electric and gas utilities the same credits on taxation of dividends contemplated for the shareholders of other widely-held corporations, the Federal Government will not be out-of-pocket. A study has been made, a summary of which is attached as Appendix I, of the distribution of the corporation and income taxes paid by Maritime Electric Company, Limited and its shareholders. This study shows that, based on estimated 1968 tax payments and pre-White Paper distribution of transfers, and taking into account the time value of money benefit to the Federal Government resulting from its use for three years of the funds to be transferred to the provinces, the benefits to the Federal Government exceed the costs by some $33,000

Consequently, it is submitted that the Federal Government could extend to the shareholders of electric and gas utilities the same credits on income tax on dividends as proposed for the shareholders of other widely-held companies without cost to itself and that the Public Utilities Income Tax Act should be continued in its present form.

APPENDIX I

MARITIME ELECTRIC COMPANY, LIMITED

Division between Federal and Provincial Governments of corporation taxes of $487,000 paid in 1968

	Tax Rate (as % of taxable income)	Division of Corporation Taxes Paid in 1968 ($000's)
Basic tax	45.00	444
Surtax (3% of 45%)	1.35	13
	46.35	457
Less: Provincial tax abatement	(10.00)	(99)
Federal tax	36.35	358
Old age security tax	3.00	30
Provincial tax	10.00	99
Total tax	49.35	487

APPENDIX I
(continued)

Benefits accruing to Federal Government as a result of corporation tax under the present provisions of the P.U.I.T.T. Act [1]

5% of Federal tax: .05 x $358,000	$17,900
Old age security tax	30,000
Interest benefit at 8-1/2% on the three-year delay in transfer of 95% of tax to province : .217 x .95 x $358,000	73,800
	$121,700

Revenues accruing to Federal Government from taxes on dividends in the hands of shareholders under White Paper

Estimated amount of eligible dividends (See Schedule A of Appendix I)	$364,000
Revenue assuming classification as public utility: .78[2] x .40[3] x $364,000	$114,000
Revenue assuming classification as widely-held corporation:	$ 25,000

1 Public Utility Income Tax Transfer Act.

2 Provincial tax abatement of 28% results in a Federal Government share of shareholder taxes of 72%.

3 Rounded value of marginal tax rate as shown on Schedule B of Appendix I.

4 Full gross-up of dividends possible since corporate taxes exceed dividend payments.

APPENDIX I
(continued)

Difference in benefits accruing to Federal Government under two methods of calculating utility corporation tax

Method I — as proposed in White Paper

Transfer of utility corporation tax direct to province in total, and treatment of tax on dividends in the hands of shareholders as from a public utility with no allowance for corporate tax paid.

Method II — utility shareholders treated as those of widely-held corporation

Continuation of P.U.I.T.T. Act provisions and treatment of tax on dividends in the hands of shareholders as from a widely-held corporation.

	Federal Benefit from:		
	Corporation Tax	Shareholders' Tax	Total Federal Benefits
Method I	—	$ 114,000	$114,000
Method II	$121,700	$ 25,000	$146,700

Gain in Federal benefits through application of Method II — $ 32,700

APPENDIX I
SCHEDULE A

MARITIME ELECTRIC COMPANY, LIMITED

Estimate of proportion of dividends eligible for tax credit

Classification of Maritime Electric Shareholders [1]	Proportion of Shareholdings	
	Common	Preferred
Eligible for tax credit:		
Individuals	64.7	60.2
Closely-held companies	23.7	2.5
Widely-held companies [2]	0.7	9.8
Mutual funds and insurance companies [2]	5.3	19.2
Unclassified shareholders	0.2	8.3
	94.6	100.0
Not eligible for tax credit:		
Non-residents	0.8	–
Pension funds	4.3	–
Non-taxable organizations	0.3	–
	5.4	–
Total	100.0	100.0

Actual dividends paid by Maritime Electric 1968:	
Common	$345,000
Preferred	37,500
	$382,500
Estimated portion of dividends eligible for tax credit:	
Common – $345,000 x .946	$326,370
Preferred – $ 37,500 x 1.00	37,500
	$363,870

1 The classification of Maritime Electric shareholders was based on a review of the current shareholders list, with direct contact with shareholders where the classification was in doubt.

2 It is assumed that all dividends paid to widely-held companies, mutual funds and insurance companies, will ultimately flow through to their individual shareholders who will receive in effect the benefit of the tax credit. No adjustment has been made for the non-resident and pension fund portion of these ultimate holdings.

APPENDIX I
SCHEDULE B

MARITIME ELECTRIC COMPANY, LIMITED

Calculation of average incremental rate for income tax which would be paid by shareholders on 1967 dividends under the White Paper proposals.

White Paper — Table 2 page 25		Taxation Statistics — Cat. No. Rv 44[1]		
Taxable Income Bracket	Combined Federal and 28% Provincial Tax Rate on Income in Bracket	Equivalent Total Income Bracket [2]	Total 1967 Dividend Income [3]	Tax on Total 1967 Dividends at White Paper Rate (B x D)
A	B	C	D	E
($)	(%)	($)	($000)	($000)
		Not Taxable	11,292	0
0 - 500	21.76	Under 3,500	36,934	8,037
500 - 1,000	23.04	3,500 - 4,000	10,579	2,437
1,000 - 1,500	24.32	4,000 - 4,500	10,655	2,591
1,500 - 2,000	25.60	4,500 - 5,000	12,019	3,077
2,000 - 3,000	26.88	5,000 - 6,000	22,988	6,179
3,000 - 4,000	28.16	6,000 - 7,000	21,781	6,134
4,000 - 5,000	30.72	7,000 - 8,000	22,401	6,882
5,000 - 7,000	33.28	8,000 - 10,000	40,389	13,441
7,000 - 10,000	35.84	10,000 - 13,000	54,339	19,475
10,000 - 13,000	38.40	13,000 - 16,000	45,969	17,652
13,000 - 16,000	42.24	16,000 - 19,000	36,465	15,445
16,000 - 24,000	46.08	19,000 - 27,000	64,129	29,551
24,000 -	51.20	27,000	210,828	107,944
			600,768	238,845

Average incremental tax rate: $\frac{238,845}{600,768} \times 100 = 39.8\%$, say 40%

1 Statistics for 1967, published in 1969 by Taxation Division, Department of National Revenue

2 Assuming married man with no dependents. $3000 of personal and other deductions added back to taxable income amounts in column A, since "Taxation Statistics" is based on total income.

3 Where the statistics did not give data in sufficient detail to report by the brackets indicated in column C, the data was pro-rated on an equal basis.

APPENDIX II

MARITIME ELECTRIC COMPANY LIMITED

Revenue increase required to equalize after-tax yield of utility shareholders with that of shareholders of widely-held corporations

(all figures in $000)

	Dividends and Taxes of Shareholders					
	Non-Residents	Non-Taxable [1]	Taxable	Total	Corporation Taxes	Total
Percent of dividends [2]	0.7	4.2	95.1	100.0		
A. Dividends taxed as from widely-held corp.						
Actual revenue	2.7	16.1	363.7	382.5	486.9	869.4
Taxes paid	.4	–	36.4 [3]	36.8	486.9	523.7
After-tax yield	2.3	16.1	327.3	345.7		345.7
B. Dividends taxed as from a utility as proposed by White Paper						
Actual revenue	2.7	16.1	363.7	382.5	486.9	869.4
Taxes paid	.4	–	145.5 [4]	145.9	486.9	632.8
After-tax yield	2.3	16.1	218.2	236.6		236.6
C. Dividends taxed as in "B" above but with after-tax yield as in "A"						
Required revenue	4.0	24.1	545.5 [5]	573.6	678.0 [6]	1251.6
Taxes paid	.6	–	218.2 [4]	218.8	678.0	896.8
After-tax yield	3.4	24.1	327.3	354.8		354.8

Increase of "C" over "A"

Revenue	1251.6 – 869.4	382.2
Taxes on dividends	218.8 – 36.8	182.0
Corporate taxes	678.0 – 486.9	191.1
Net dividends to non-residents	3.4 – 2.3	1.1
Dividends to non-taxable	24.1 – 16.1	8.0
		382.2

1 Pension funds and non-taxable organizations.
2 Derived from Appendix I Schedule A.
3 Average rate of Appendix I Schedule B – full gross-up of dividends
4 Average rate of Appendix I Schedule B – no gross-up of dividends.
5 Revenue required to yield $327,300 after 40% taxes paid.
6 Corporation tax rate on increased earnings assumed to be 50%.

APPENDIX G

1 - NEWFOUNDLAND LIGHT & POWER CO. LIMITED
2 - NOVA SCOTIA LIGHT AND POWER COMPANY LIMITED
3 - MARITIME ELECTRIC COMPANY LIMITED
4 - CANADIAN GAS ASSOCIATION
5 - CANADIAN UTILITIES LIMITED
6 - CANADIAN WESTERN NATURAL GAS COMPANY LIMITED
7 - NORTHLAND UTILITIES LIMITED
8 - NORTHWESTERN UTILITIES LIMITED

Analysis of Appendices "A","B","C","D","E" and "F" by Senior Advisor

The attached [redacted] briefs relate to the same subject. This subject is the proposals contained in the White Paper that Canadian shareholders of public utilities be denied the dividend tax credit proposed for Canadian shareholders of other Canadian companies as 95% of taxes collected from public utility companies is turned over to provincial governments.

Members of the Committee are aware that one of the major proposals of the White Paper is that Canada requires that all Canadian corporations pay an annual corporation tax of 50% (40% to Canada, 10% to provinces) to ensure that Canadian shareholders be entitled to a dividend tax credit of varying amounts on dividends received from Canadian companies. This proposal, commonly referred to as "Grossing-Up Canadian Dividends", has already created serious controversy in Canada and has been referred to in Special Study No. 4.

The authors of the White Paper, seeking to ensure absolute uniformity in their proposals, have denied the dividend tax credit to shareholders of public utilities on the grounds that Canada has not retained the annual corporation income tax collected by it, but by agreement made with provincial governments, turns over 95% of such taxes to the provincial governments. Hence the reasoning appears to be that because Canada has not retained taxes it collected from public utilities, Canadian shareholders of public utilities should be denied the dividend tax credit.

Members of the Committee will be hearing several briefs on this subject and will have to decide whether the adoption of the theory of "Grossing-Up" of Canadian dividends will be of benefit to Canada, and whether the proposal to deny dividend credits to Canadian shareholders of public utilities will cripple such Canadian companies.

There is attached the usual schedule showing present tax law, and the White Paper proposals.

Principal Subject: Dividend Tax Credits to Shareholders of Investor-Owned ~~Electric~~ PUBLIC Utilities

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Under the present Income Tax Act, investor-owned electric utilities are subject to annual corporation income taxes in the same manner as any other Canadian corporation, subject to an exception referred to below. The Canadian shareholders of this type of public utility are entitled to deduct from tax 20% of dividends received from the utility in the same manner as permitted to shareholders of any Canadian company.	The authors of the White Paper propose the following rules for all Canadian companies and for the Canadian shareholders of widely-held Canadian companies. 1.39 The government proposes to alter the method of taxing corporations by establishing a single rate of corporation tax and providing a system of credits to shareholders for corporate taxes paid. An important distinction would be made between private, closely-held corporations and public, widely-held corporations.	These briefs relate to the proposals of the White Paper that would deny to shareholders of a public utility any dividend tax credit because the federal government has turned over 95% of the annual taxes collected from such companies to the provincial governments. A portion of the Briefs point out the harmful effect of the proposal on the Canadian shareholders of the company by depressing the market value of their holdings and reducing the yield of dividends received. A portion of the Briefs point out the harmful effect of the proposals on the company itself, and of the difficulty or impossibility of financing in Canada in the future.

Principal Subject: Dividend Tax Credits to Shareholders of Investor-Owned ~~Electric~~ Public Utilities

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
<u>Section 85 of the Income Tax Act</u> This section permits certain public utilities that sell in Canada electrical energy, gas energy or steam energy, to reduce the annual corporation tax otherwise payable, by 2% of a portion of the income derived from the sale of such energy. <u>Public Utilities Income Tax Transfer Act</u> The above act provides that the federal government will turn over to the provincial government 95% of the corporation taxes collected from certain electric, steam, and gas utility corporations in that province.	1.42 Widely-held corporations are usually larger businesses where the link between shareholders and management is tenuous. Such corporations are themselves important economic entities. Their products or services are usually sold in competition with other large corporations, where prices yield an adequate return after paying corporate tax. One half the corporate income tax paid by such corporations would be regarded as a prepayment of individual tax for individual Canadian resident shareholders, but the other half would not be linked in this way. Shareholders receiving dividends from profits taxed under the new plan would be liable for tax on the dividend plus an amount of "creditable tax" equal to half the dividend and would be given credit for that amount of tax. This system would be roughly equivalent to the present dividend tax credit for taxpayers in the 50-per-cent tax bracket and would be more favorable for those in lower tax brackets. It would thus provide a powerful incentive for investment by Canadians in Canadian corporations.	A portion of the Briefs forecasts the probable increase in rates that will follow the adoption of the proposals.

Principal Subject: Dividend Tax Credits to Shareholders of Investor-Owned ~~Electric~~ Public Utilities

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	The White Paper makes the following specific proposals respecting the shareholders of electric, gas or steam utilities: 4.63 In 1966, Parliament passed the Public Utilities Income Tax Transfer Act under which the Minister of Finance turns over to the provincial governments 95 per cent of the corporation tax collected from certain electric, steam and gas utility corporations. 4.64 The whole scheme of the present proposals contemplates that shareholders of Canadian corporations receive a credit from the federal government for part or all of the federal corporation tax paid by their corporation. It would be contrary to this general scheme if the federal government gave to shareholders of these utility corporations credit for taxes which the federal government has turned over to the provincial governments, and it does not propose to do so. 4.65 It would be possible to give the shareholders credit for the taxes which the federal government retains. However, the amounts would be very small and the government considers it more efficient to ask Parliament to amend the Public Utilities Income Tax Transfer Act so that all of these taxes are turned over to the provinces, who could then decide to what extent they should be turned over to the corporation or its shareholders.	

APPENDIX H

SPECIAL STUDY NO. 4 (Revised and Supplemented)

GROSSING-UP OF CANADIAN DIVIDENDS

INTRODUCTION

One of the major proposals of the authors of the White Paper is set out in the following paragraphs thereof:

> 1.39 The government proposes to alter the method of taxing corporations by establishing a single rate of corporation tax and providing a system of credits to shareholders for corporate taxes paid. An important distinction would be made between private, closely-held corporations and public, widely-held corporations.
>
> 1.40 For closely-held corporations, which are usually smaller businesses managed by the shareholders, the tax should be related as closely as possible to rates paid by individual shareholders. There is usually a close identity between the shareholders and the corporation. These corporations usually compete in markets with unincorporated businesses subject only to personal income tax. Under the proposed plan the federal income tax paid by such corporations would be treated as a prepayment of the personal income tax on behalf of individual resident shareholders. Under certain conditions the corporation could elect to be taxed as a partnership of its shareholders. In other cases the shareholders would pay tax on a sum that includes their dividends plus a related amount of corporate tax already paid; and they would then claim credit for the corporate tax paid, and qualify for a refund if their own rates are lower than the corporate rate.
>
> 1.42 Widely-held corporations are usually larger businesses where the link between shareholders and management is tenuous. Such corporations are themselves important economic entities. Their products or services are usually sold in competition with other large corporations, where prices yield an adequate return after paying corporate tax. One half the corporate income tax paid by such corporations would be regarded as a prepayment of individual tax for individual Canadian resident shareholders, but the other half would not be linked in this way. Shareholders receiving dividends from profits taxed under the new plan would be liable for tax on the dividend plus an amount of "creditable tax" equal to half the dividend and would be given credit for that amount of tax. This system would be roughly equivalent to the present dividend tax credit for taxpayers in the 50-per-cent tax bracket and would be more favorable for those in lower tax brackets. It would thus provide a powerful incentive for investment by Canadians in Canadian corporations.

To implement the proposal outlined in Paragraph 1.39 above, the authors of the White Paper deem it necessary to eliminate the lower rate of taxes allowed on the first $35,000 of taxable income, to confiscate by way of income tax any subsidies paid to encourage scientific research and the like, remove tax incentives allowed to the extractive industries and new industries in designated areas, and levy Canadian taxes on the earnings of foreign subsidiaries of Canadian companies.

The justification of this seemingly ruthless sweeping away of existing benefits to encourage industry is to grant tax credits to Canadian shareholders who may receive dividends from Canadian companies within a period of two and one-half years after the year in which the income is earned by the corporation.

The tax-credit to be permitted Canadian shareholders will be computed in accordance with the following formula:

	Closely-held Corporations		Widely-held Corporations	
	Federal	Provincial	Federal	Provincial
Canadian dividend received	100		100	
Amount to be added to dividend received to achieve "grossing-up"	100		50	
Amount of dividend to be included with other income of individual shareholders	200		150	
Tax on total income at increased rates proposed in White Paper	XX	28% of federal tax	XX	28% of federal tax
Less deduction from tax payable on total income	80% of dividend received of 100	20% of dividend received of 100	40% of dividend received of 100	10% of dividend received of 100
Net tax payable	XX	XX	XX	XX

The system of grossing-up dividends proposed for Canada by the authors of the White Paper was first introduced in Great Britain in the mid-1800s at a time when the principles of taxation were being developed on a trial and error basis.

This system has in more recent years been progressively abandoned by Great Britain as failing to meet present day demands of governments.

The grossing-up system was finally abandoned by Great Britain in 1965. An extract from the Budget Statement of the Chancellor of the Exchequer of April 6, 1965, may be of interest to members of the Standing Committee. It follows, with underlining inserted by your advisor:

> "Our present method of taxing corporate bodies goes back to the days before the joint stock company, as we know it, existed, when the few companies that did exist were thought of as being in the nature of large partnerships. At that stage, income tax was virtually a flat-rate tax: it applied to the income of companies and individuals alike; and when a company distributed its income to its shareholders in the form of a dividend, a second lot of tax was not exacted. Since those days, there have been extensive changes both in the tax system and in the status and position of companies.
>
> First, the personal income tax has become a graduated tax, differentiated according to the circumstances of each taxpayer, and made progressive by reduced rate relief at the lower end of the scale, and surtax at the upper end. Secondly, company taxation has been altered by the introduction of profits tax, which is imposed on the whole profits of a company, whether or not distributed, and is not repayable to shareholders. <u>These changes have made obsolete the idea that companies and individuals should be treated for tax in the same way. By separating formally the two taxes, namely, the tax on corporations and the tax on individuals, we shall be bringing the tax system of the United Kingdom into line</u>

with reality and adopting what has become the general practice throughout the world.

Hitherto, any idea of reforming the tax system by introducing a corporation tax in this country has foundered because of the widely held view that to levy a separate tax on company profits which is distinct from, and additional to, the income tax levied on individuals would constitute 'double taxation' of company profits. The profits tax already contradicts this argument. The truth is that only part of a corporation's income is distributed to the shareholders in the form of dividends; the rest is not part of personal income and cannot be treated as such. The majority of the Royal Commission on Taxation came near to this view when it said:

> 'We accept the necessity for the subjecting of company profits to a special tax regime that is something more than a mere attempt to collect personal income tax in advance.'

But it baulked at the logical conclusion, which is that there should be a separate tax on the profits of corporations quite distinct from the income tax that is levied on distributed profits.

There then remains the question of how to frame the tax on company profits. As soon as it is divorced from the taxation of individuals, we are free to draw it up on principles most conducive to economic growth and efficiency. The two ways open to us of raising the same amount of revenue from corporations are, either to confine the tax to undistributed profits and levy it at a relatively high rate; or, alternatively, to impose a tax on the whole profits, irrespective of distributions, at a much lower rate.

The latter tax, in my view, has a much greater economic and incentive value than the former. A tax confined to undistributed profits penalises investment and growth; it severely handicaps the young and dynamic companies which may rely on

ploughed-back profits for expansion. A tax on the whole profit has the opposite effect. It makes it possible to shift the burden of taxation in such a way as to relieve the faster-growing companies, which are generally low distributors, and thus enable them to expand even faster. It will place more of the burden on those companies which are high distributors. It gives a strong incentive to all companies to plough back more of their profits for expansion. Finally, the incentives to cut costs and to raise efficiency through new investment are much stronger, and must be much stronger when a lower percentage of additional profits is taken in taxation than under the present system where 56¼ per cent. of any additional profit would go to tax.

The present system is also unnecessarily complicated because of the existence of two taxes - income tax and profits tax - levied broadly on the same income, but according to different rules. It is a patchwork system and it is not standing up to the strains that result from the efforts of Governments to use the tax system for economic purposes. The result has been the growth of abuses and anomalies, such as recovery by companies or individuals of large sums from the Revenue by way of repayment of tax, although no corresponding sum has ever reached the Exchequer".

(Simon's Income Tax - Vol 2A - Page 404)

It may be that the portions underlined of the above statement have a meaning equally applicable to Canada.

Members of the Committee will be hearing briefs on the proposal to gross-up Canadian dividends. They will have to consider whether Canada, if it abandons its long-established system of taxing corporations in favour of a system recently abandoned by the country that introduced it, may be exposing Canadian business to those risks referred to by the Chancellor of the Exchequer of Great Britain on April 6, 1965.

SPECIAL STUDY NO. 4

GROSSING-UP OF CANADIAN DIVIDENDS

THE PROBLEM

In theory, if all Canadian closely-held corporations distributed annual earnings, less income taxes paid thereon, by way of annual dividends to their shareholders, there would never be an accumulation of undistributed earnings by such corporations and there would be no problem respecting the taxation of such surplus. There would also be no surplus funds remaining for expansion and there would in fact be no expansion of small Canadian business operations.

Traditionally the small Canadian businessman has lacked capital, and has also lacked the means to raise it from others, or to borrow it, and in order to survive and expand has had to plow back earnings and refrain from paying dividends to himself.

If such small Canadian businessmen are to survive, means must be found to enable earnings to be retained and plowed back into the business without creating potential tax liabilities, which though deferred, will eventually have to be paid at the cost of ruining the small business enterprise.

The problem of surplus accumulations by Canadian closely-held corporations is well described in the following paragraphs of the White Paper:

> 4.1 About 200,000 corporations file Canadian income tax returns. These corporations vary greatly in size; some are among the largest in the world, others the incorporation of a one-man enterprise. The large corporations may well have thousands of shareholders; the one-man business often will have only one shareholder (or one owning almost all of the shares and others with a nominal interest if the Corporations Act requires that a corporation have more than one shareholder).

It is interesting to note that 200,000 corporations file income tax returns, whether or not they are actually liable to pay annual income taxes. Information furnished your Committee by the Minister of Finance under date of February 11, 1970 shows the number of Canadian corporations paying taxes, and their average taxable incomes to be as follows:

Taxable Income Range	No. of Companies
$ 1 to $ 1,999	18,612
2,000 to 4,999	15,523
5,000 to 9,999	15,521
10,000 to 19,999	16,356
20,000 to 34,999	15,354
	81,366
Over $35,000	10,913
	92,279

4.5 Canada has levied a tax on the incomes of corporations since 1917. For the first 20-odd years—until the war—this tax was lower than the top rates of personal income tax and a further personal income tax was due if and when the corporation profits were distributed to individual shareholders.

4.6 Such a system has certain inevitable consequences, which can best be explained by considering the case of a corporation owned by one individual:

(1) The total tax paid on income received by the corporation and then passed on to the individual as a dividend is greater than the tax paid if the income was received directly by the individual (for example, if the corporation tax rate was 30 per cent and the personal tax rate 50 per cent, the tax would be $50 if $100 of income was received directly, compared with a total tax of $65 if the $100 was passed through the corporation —$30 corporate tax, leaving $70 for dividends, on which the personal tax would be $35);

(2) However, the tax that must be paid immediately—the corporate tax—may well be less than if the individual received the income directly, and the balance of the tax need not be paid unless or until the profits are passed on to the individual (in the example mentioned above the corporate tax was only $30, whereas the personal tax would have been $50);

(3) If the profits can be left in the corporation long enough, having the use of the tax savings and the ability to invest at higher after-tax rates of return can more that offset the extra tax paid as a result of using the corporation;

(4) The longer profits are left in the corporation, the more the shareholder considers them as his own and the more he resents having to pay a further tax to transfer them from his corporation to himself (and the longer the profits are in the corporation, the more time he has to try to devise ways of making the transfer tax-free); and

(5) If several years' profits are drawn out in one year, the result may well be that a substantial part of the dividend is pushed into a tax bracket with a rate considerably higher than the shareholder's usual marginal rate (and substantial amounts may be required from time to time by the shareholder to meet personal financial needs).

Paragraph 4.6 seems to infer that surplus is accumulated by a closely-held corporation to enable the principal shareholder to devise means to remove this surplus free of tax. Surely it must be realized by the authors of the White Paper that small businesses accumulate surplus to survive and expand and not as part of a scheme to equalize or avoid taxes.

> 4.7 There is little likelihood of the shareholder of a public corporation feeling that he owns the assets of the corporation, and little likelihood of the corporation paying out several years' earnings in one year. Further, the shareholder in a public corporation is to a considerable extent unaware of the operation of the interaction of the personal and corporate tax rates: he considers that his income from his shares is his dividend (plus the gain on the sale of the shares, or minus the loss). As a result, most of the pressure for change in the corporate tax system during the first 25 years centred on closely-held corporations. In particular, it grew out of the problem created by many years' profits accumulated in the corporation, and the abnormally large tax due if they were withdrawn—to pay estate taxes or succession duties, for example.

One may be permitted to wonder how many investors in the shares of a widely-held corporation "considers that his income from his shares is his dividend (plus the gain on the sale of the shares, or minus the loss)".

Particular attention is drawn to the last two sentences of Paragraph 4.7 which read as follows:

> "As a result, most of the pressure for change in the corporate tax system during the first 25 years centred on closely-held corporations. In particular, it grew out of the problem created by many years' profits accumulated in the corporation, and the abnormally large tax due if they were withdrawn - to pay estate taxes or succession duties, for example."

Having described how the problem of accumulated earnings of closely-held corporations have developed in past years, the authors of the White Paper then partially describe past attempts to mitigate somewhat the tax problems inherent in surplus accumulations in the following paragraphs:

> 4.8 Special opportunities were given to corporations to distribute profits accumulated up to 1930 and 1939, respectively. In the former case the distribution was free of tax. In the latter case it was taxed at rates ranging from 15 per cent to 33 per cent.

It might be well to observe that average income taxes payable by Canadian corporations for the years 1917 to 1929 were about 8%. Therefore corporations were permitted to distribute, or more often capitalize accumulated surplus to the end of 1929 at a total tax cost of 8%.

It is believed that most Canadian corporations took advantage of this legislation.

The annual corporation tax rates for the years 1930 to 1939 varied from 8% in 1930 to 18% in 1939, or an average rate of about 12%. Accordingly earnings accumulated in this period could be distributed or capitalized at a total tax cost of from 8% plus 15% of 92 or 22%, to 8% plus 33% of 92 or 38%.

It is believed that many Canadian closely-held corporations took advantage of this legislation.

The authors of the White Paper apparently omit any reference to the important legislation respecting surplus accumulations introduced by the enactment of Section 105 of the present Income Tax Act in 1950. This section provided that:

(1) Surplus accumulations at the end of the 1949 fiscal period could be distributed free of further tax if the corporation paid a tax of 15% of such surplus.

As the average rate of corporation tax in the years 1940 to 1950 was about 50%, the enactment of this legislation meant that earnings accumulated to the end of 1949 could be distributed at a total tax cost of 57½%.

It would seem that many closely-held corporations and their shareholders took advantage of this portion of the legislation.

(2) Surplus accumulated from 1949 to date could be distributed as follows:

(i) 50% of such earnings had first to be distributed as dividends and the shareholders subjected to tax thereon, less a deduction from tax of 20% of the amount of the dividend received, and

(ii) the remaining 50% of such earnings could be distributed free of further tax provided the corporation paid a tax of 15% thereon.

In 1955, Section 105B of the present Income Tax Act was enacted which provided that a corporation could distribute its entire accumulated surplus upon payment of a tax of 16-2/3% of such surplus.

It would appear that very many, if not most, closely-held corporations paid tax on surplus accumulated to the end of 1949, but baulked at paying the taxes on earnings accumulated in 1950 and subsequent years.

In the years 1950 to 1963, many closely-held corporations took active steps to distribute surplus accumulations at a tax cost that was less than provided for by the Income Tax Act. It would appear that these activities were viewed with tolerance, if not benevolence, by the authorities of the day. As a result these activities multiplied.

In 1964, a concerted drive was mounted by the Taxation Division of the Department of National Revenue upon these activities carried out in past years, with the result that all such taxpayers were required to pay a tax of 16-2/3% of dividends deemed to have been distributed to shareholders.

Today a state of complete confusion exists as to the taxes payable on the accumulated surpluses of closely-held corporations.

In summary, it can be stated:

(1) The problems of accumulated surplus apply only to Canadian closely-held corporations. They do not apply to widely-held corporations.

(2) The problem arises from the reluctance of shareholders of closely-held corporations to pay total taxes of about 60% (52% corporation taxes and 16-2/3% of 48% special taxes) upon amounts withdrawn from such corporations.

(3) Widely-held corporations have also plowed back earnings to expand business, but such surplus accumulations do not constitute a potential tax problem for their shareholders, except in the unlikely event of the liquidation of the corporation.

(4) Widely-held corporations have not been able to utilize the provisions of Section 105 to pay a 15% tax on behalf of shareholders, as many smaller shareholders pay taxes on dividends of less than 15%. However, the present 20% Canadian dividend credit appears to have reduced very considerably the taxes payable by Canadian shareholders of widely-held corporations on dividends received therefrom.

Chapter 3

SPECIAL STUDY NO. 4

GROSSING-UP OF CANADIAN DIVIDENDS

THE PROPOSED SOLUTION TO THE PROBLEM

The authors of the White Paper propose to solve the problem created by the accumulation of surplus of closely-held Canadian corporations by the adoption of two sweeping measures. These measures are:

(1) To require all Canadian companies, whether widely-held or closely-held, to pay annual corporation income taxes of 50% (40% federal and 10% provincial) on their respective incomes.

This measure will involve the cancellation of the lower rate of tax on the first $35,000 of taxable income, the taxation of subsidies received for scientific research, the cancellation of incentives granted to the extractive industry or to new industry in areas of lesser employment, and the like; and

(2) To require the Canadian shareholders of all Canadian closely-held or widely-held corporations to pay increased taxes on an inflated amounts of dividends received from the corporations and to permit the deduction from tax of varying percentages of the dividends received. The tax payable on dividends received will be computed as follows:

	Closely-held Corporations		Widely-held Corporations	
	Federal	Provincial	Federal	Provincial
Canadian dividend received	100		100	
Amount to be added to dividend received to achieve "grossing-up"	100		50	
Amount of dividend to be included with other income of individual shareholders	200		150	
Tax on total income at increased rates proposed in White Paper	XX	28% of federal tax	XX	28% of federal tax
Less deduction from tax payable on total income	80% of dividend received of 100	20% of dividend received of 100	40% of dividend received of 100	10% of dividend received of 100
Net tax payable	XX	XX	XX	XX

(3) The dividend tax credits of 80% and 40% referred to in (2) above will only be granted to shareholders provided the corporation distributes the dividend within 2½ years after the end of the fiscal period in which the income is earned. It therefore follows that the corporation will be under some very real compulsion to distribute first any surplus accumulated before the new system becomes law, and thereafter to distribute subsequent earnings within the 2½-year period.

The paragraphs of the White Paper that refer to the proposals summarized above follow below:

TAXATION OF DIVIDENDS

A - Proposal

1.39 The government proposes to alter the method of taxing corporations by establishing a single rate of corporation tax and providing a system of credits to shareholders for corporate taxes paid. An important distinction would be made between private, closely-held corporations and public, widely-held corporations.

1.40 For closely-held corporations, which are usually smaller businesses managed by the shareholders, the tax should be related as closely as possible to rates paid by individual shareholders. There is usually a close identity between the shareholders and the corporation. These corporations usually compete in markets with unincorporated businesses subject only to personal income tax. Under the proposed plan the federal income tax paid by such corporations would be treated as a prepayment of the personal income tax on behalf of individual resident shareholders. Under certain conditions the corporation could elect to be taxed as a partnership of its shareholders. In other cases the shareholders would pay tax on a sum that includes their dividends plus a related amount of corporate tax already paid; and they would then claim credit for the corporate tax paid, and qualify for a refund if their own rates are lower than the corporate rate.

1.41 The government believes that this is a fairer way of taxing the income of Canadians which flows through corporations than the existing system with its lower rate of corporate tax on $35,000 of profits annually. It proposes to remove this lower rate gradually over a period of five years. Thereafter, the benefits of low rates of tax would go to shareholders with small incomes rather than to corporations with small incomes.

1.42 Widely-held corporations are usually larger businesses where the link between shareholders and management is tenuous. Such corporations are themselves important economic entities. Their products or services are usually sold in competition with other large corporations, where prices yield an adequate return after paying corporate tax. One half the corporate income tax paid by such corporations would be regarded as a prepayment of individual tax for individual Canadian resident shareholders, but the other half would not be linked in this way. Shareholders receiving dividends from profits taxed under the new plan would be liable for tax on the dividend plus an amount of "creditable tax" equal to half the dividend and would be given credit for that amount of tax. This system would be roughly equivalent to the present dividend tax credit for taxpayers in the 50-per-cent tax bracket and would be more favorable for those in lower tax brackets. It would thus provide a powerful incentive for investment by Canadians in Canadian corporations.

1.43 Examples of this plan are set out in paragraphs *4.25* and *4.37*.

1.44 This new system would:

- offer a substantial inducement for Canadians to invest in Canadian business;
- when combined with the proposed method of taxing capital gains, make possible a fair and fully effective but economically tolerable tax system;
- prevent surplus stripping and most other tax avoidance devices;
- be fairer in its treatment of lower-income shareholders than the present dividend tax credit and preferred low rate of tax on the first $35,000 of corporate income.

4.19 The government's proposal is to create one set of rules for the closely-held corporation— the incorporated proprietorship or partnership— and another set of rules for the widely-held, public corporation. This distinction reflects the difference in the relationship between the two types of corporations and their respective shareholders. It also reflects the fact that, by and large, the closely-held corporation competes with proprietorships, partnerships and of course with other closely-held corporations, while the public corporation competes with other public corporations, both Canadian and foreign.

B – Estimates

8.10 It has been necessary to estimate the proportion of the dividends received, and which would be received, by Canadian-resident individuals and by Canadian closely-held corporations, respectively, from closely-held Canadian corporations and from widely-held Canadian corporations. Assumptions have also been made about corporate behavior in the payment of dividends under the tax arrangements proposed for widely-held and closely-held Canadian corporations. It has been assumed that, once the system is fully effective, closely-held corporations effectively controlled in Canada would pay out the whole of their profits in order that shareholders could take full advantage of the credit for corporate tax. Most of the additional payout is expected to be in the form of stock dividends. During the first four years there would be a tendency on the part of closely-held corporations controlled by high-income Canadians to delay this increased payout so that the marginal rates would have decreased as far as possible towards 50 per cent. All in all, we would expect only a modest increase in the total of cash and stock dividends paid by closely-held corporations in the first year of the new system, but a substantial increase in the fifth and subsequent years. We have assumed that widely-held corporations would not increase their dividends as a result of the tax proposals.

8.22 The final item to be taken into account is the proposed change from the dividend tax credits to a new system for giving shareholders credit for part or all of the Canadian taxes paid by their corporations. Our expectations concerning the dividend policies of corporations were noted in paragraph *8.10*. On the basis of those expectations it is estimated that this change would have cost $140 million in personal tax revenue in 1969 if that had been the first year of the system and $230 million if it had been the fifth year of the system. The cost of this change must of course be considered together with the increased revenue expected from the removal of the low rate of corporation tax and from the taxation of dividends from widely-held Canadian corporations when received by closely-held corporations. Together these two corporate changes would have produced $155 million in tax revenue in 1969 if that had been the first year of the proposed system and $450 million if it had been the fifth.

8.23 The $140 million is the net of three amounts. First, the estimated credit to be given to shareholders would reduce revenues. Offsetting this there would be additional revenue from the tax collected on that credit, and on the increased dividends it is expected that the proposed system would prompt. Finally the present 20-per-cent dividend tax credit would be cancelled: this would reduce the net cost of the proposed system. The following schedule illustrates the interaction of these three factors: the provincial figures are based upon a provincial tax at 28 per cent of federal tax. The figures are in millions of dollars:

	Combined Federal and Provincial	*Provincial Share*	
Tax on additional dividends and on the taxable credit itself	$ 210	(28/128)	$ 45.9
Dividend tax credit cancelled	130	(28/128)	28.4
	340		74.3
Credit for corporation tax	480	(1/5)	96.0
Net cost	$ 140		$ 21.7

C – Distributions of Dividends by Closely-Held Corporations

4.24 In the case of those corporations which are not to be treated as partnerships, parity with the shareholders of partnership corporations would be achieved in two steps. There would be a tax of 50 per cent on the taxable income of the corporation. However, when the net profits are distributed to the shareholders, credit would be given for the full amount of the tax paid by the corporation on those profits.

4.25 An example may help to explain how this system would work. A closely-held corporation with profits of $20,000 would pay a tax of $10,000, leaving $10,000 to be distributed to the shareholders. When the corporation pays the next $10,000 in dividends, it would instruct the shareholders to report $20,000 as their income for tax purposes (the before-tax profit of the corporation) and to claim credit for the $10,000 of tax paid by the corporation. A shareholder who receives a dividend of $100 would therefore report $200 as his income from the corporation and would show on his return that $100 tax had been paid by the corporation. If his marginal tax rate is 40 per cent, the tax on the dividend would be $80 and he would be entitled to a refund from the government of the extra $20. In this way the ultimate tax on his share of the profits of the corporation would be the same as if he had received the $200 directly.

4.26 This procedure of giving credit to the shareholder for taxes paid by the corporation would be applied both to cash dividends and to stock dividends, so that the process should not by itself force private corporations to pay out in cash a higher proportion of their profits than they would under the present system. In the case of a stock dividend, the shareholder would of course not have received any cash from the corporation with which to pay his tax. However, the credit he receives for the tax paid by the corporation would cover his liability on the dividend unless his marginal tax rate exceeds 50 per cent. Therefore the system would not result in taxpayers being forced to pay tax at a time when they lack means to satisfy the tax liability.

4.27 For the shareholder to receive credit for tax paid by a corporation, the corporation would have to pay the appropriate dividends—either cash or stock—within a limited period of time. It is proposed that tax paid with respect to a given taxation year should be creditable only if it is passed through to the shareholders within 2½ years from the end of the corporation's taxation year. This is necessary in order to limit the amount of outstanding claims against the government: if corporations accumulated creditable tax for 10 or 15 years, large dividends at the end of that time could seriously affect government revenues in the year of distribution. Further, the rule would limit the amount of creditable tax in any given corporation at any given time and so reduce the temptation to taxpayers who cannot make use of creditable tax to "sell" it to taxpayers who can make use of it.

4.28 The government believes this is a fairer way of dealing with the income of Canadians flowing through closely-held corporations. In effect, the present system gives an arbitrary concession to small corporations. The proposed system would graduate the tax according to the circumstances of the shareholder. Therefore the benefit would go to shareholders with small incomes rather than to corporations with small incomes.

4.32 Taken together these proposals concerning closely-held corporations should provide a tax system with the same effect on business carried out through such a corporation as on business carried on through a proprietorship. It should also collect the same tax on the investment income of a Canadian individual whether he holds his investments directly, or whether he holds them through a personal holding corporation.

4.33 Meanwhile gains realized on the sale of shares in closely-held corporations would be taxed as ordinary income, and losses suffered on the sale of such shares would be deductible from other income for tax purposes. When coupled with the system of full integration, this would mean that the tax effects would be the same whether an individual causes his corporation to sell its assets to a prospective purchaser or chooses to sell his shares to that purchaser, thereby giving the purchaser indirect control of the assets.

D – Tax on Recaptured Depreciation

4.79 To secure tax on the recapturable depreciation, it is proposed that part of the tax paid by closely-held corporations be treated as non-creditable until non-creditable tax has been collected on the amount that would have been taxable under the present system. This would of course not accomplish the objective with respect to corporations that are to be treated as partnerships. Shareholders of such corporations would have to elect to value their shares in the same manner as a proprietor or partner is to value his business assets—at values that would leave inventory profits and recapturable depreciation taxable.

E – Distribution of Dividends by Widely-Held Corporations

1.42 Widely-held corporations are usually larger businesses where the link between shareholders and management is tenuous. Such corporations are themselves important economic entities. Their products or services are usually sold in competition with other large corporations, where prices yield an adequate return after paying corporate tax. One half the corporate income tax paid by such corporations would be regarded as a prepayment of individual tax for individual Canadian resident shareholders, but the other half would not be linked in this way. Shareholders receiving dividends from profits taxed under the new plan would be liable for tax on the dividend plus an amount of "creditable tax" equal to half the dividend and would be given credit for that amount of tax. This system would be roughly equivalent to the present dividend tax credit for taxpayers in the 50-per-cent tax bracket and would be more favorable for those in lower tax brackets. It would thus provide a powerful incentive for investment by Canadians in Canadian corporations.

4.34 By and large, a Canadian widely-held public corporation competes with other public corporations. In this league it is natural for the competition to bear a corporation income tax and we consider it likely that some level of corporation tax is passed on to customers in the price which the corporations charge for their goods and services.

4.35 At present United States corporations bear tax at 52.8 per cent and United Kingdom corporations at 45 per cent. Against this background a Canadian corporation tax of 50 per cent seems reasonable and competitive. For this reason the government does not propose to give Canadian shareholders of such corporations full credit for the corporation tax paid by those corporations.

4.36 However, the government does want to reform the dividend tax credit. It proposes to replace the existing credit with a system giving Canadian shareholders credit for one-half the Canadian corporation tax paid by the corporation on the profits from which the dividend is paid.

4.37 Again, an example may help to explain how the system would work. A Canadian public corporation with profits of $1,000,000 would pay a tax of $500,000, leaving $500,000 available for distribution to the shareholders. If it pays the $500,000 out in dividends, it would instruct the shareholders to report $750,000 as their income for tax purposes and to claim credit for $250,000 of the $500,000 of corporate tax paid by the corporation. A shareholder who receives a dividend of $100 would therefore report $150 as the income from the corporation and would show on his return that $50 tax had been paid by the corporation, $40 federal and $10 provincial. If his marginal tax rate is 40 per cent, the tax on the dividend would be $60 and he would owe the governments $10. If his marginal tax rate is less than one-third he would be entitled to a refund. As in the case of closely-held corporations, this procedure would be applied both to cash dividends and to stock dividends so that the process should not by itself force corporations to pay out in cash a higher porportion of their profits than they would under the present system. Also, as in the case of closely-held corporations, the credit would only be given if the corporation declares these dividends within the time limits prescribed.

4.38 The government believes this way of providing an incentive to Canadians to purchase shares in Canadian corporations is fairer than the dividend tax credit. It would give all Canadian individuals credit for the same amount of corporate tax on any given dividend.

4.39 It would also mean that credit is given only for taxes actually paid to Canada so that the incentive would be limited to a forgiveness of tax and would not involve a net payment from the Canadian treasury.

4.40 While credit would not be given for foreign corporation taxes paid, it is proposed that corporations receiving income from other countries be enabled to pass through to their shareholders credit for 15 percentage points of withholding tax levied by those foreign countries on the income received. This would provide neutrality between those taxpayers who receive foreign investment income directly and those other taxpayers who receive it through a Canadian corporation. It would also, to a substantial extent, offset the loss of the dividend tax credit for shareholders of those corporations. This provision is explained in more detail in Chapter 6.

4.41 This system of partial credit also produces a rough balance when combined with the proposal that gains or losses on the sale of shares in Canadian widely-held corporations be taken into account only to the extent of 50 per cent in computing taxable income. This balance is not precise. It is almost exact in the case of upper-income taxpayers, those most likely to be able to arrange their affairs to receive their income in the form that reduces taxes to a minimum. It is less balanced in the case of taxpayers in lower rate brackets. They would be better off to receive their income in dividends than in the form of capital gains. This probably coincides with their natural inclination to buy into well-established Canadian corporations where their investment is less at risk.

4.42 As mentioned above and in Chapter 3, the government proposes that half of the gain on the disposal of a share of a Canadian public corporation be taken into account in computing taxable income. This lower rate of tax on the gain would complement the partial credit given for corporate tax and provide the other half of the government's incentive to Canadians to invest in Canadian corporations. To forestall a fairly straightforward tax-avoidance technique, it would be necessary to grant deduction for only half of the loss on the sale of such a share.

4.43 These proposals obviously put considerable importance on the distinction to be drawn between closely-held Canadian corporations and widely-held Canadian corporations. The rules proposed for defining a widely-held corporation are as follows:

(1) All corporations with shares listed on a prescribed Canadian stock exchange on the day the White Paper is published would be deemed to be widely-held corporations.

(2) All corporations which subsequently list their shares on these exchanges would become widely-held corporations on the day on which their shares are so listed.

(3) Corporations which can meet specified tests concerning the number of shareholders and the number of shares held by those shareholders could elect to be classified as widely-held corporations.

(4) The Minister of National Revenue would have the power to designate other corporations as widely-held corporations if they meet certain tests relating to number of shareholders, dispersal of shares and public trading in shares. (In practice this would mean that most corporations with shares traded "over the counter" would be classified as widely-held corporations.)

(5) Once a corporation is classified as a widely-held corporation it would always remain a widely-held corporation.

Only corporations incorporated in Canada would be eligible to be treated as Canadian widely-held corporations.

4.44 From the time a corporation becomes a widely-held corporation shareholders would receive credit for only half the tax paid by the corporation. Any creditable tax on hand at the time of transition would effectively be cut in half.

4.45 Proceeds from the sale of a share of such a corporation after it becomes a widely-held corporation would be taken into income for tax purposes to the extent of 50 per cent, even though part of the increase in value may well have occurred while the corporation was a closely-held corporation. This provision reflects the expectation that closely-held corporations would distribute—either by cash dividend or stock dividend—almost all of their profits to their shareholders, and that the accruing capital gain, if any, on such shares would therefore relate almost entirely to the expectation that the corporation would be able to earn greater profits in future. Because the shareholders would receive credit for only half of the corporation tax paid on these future profits, it is reasonable that the government collect tax only at half rates on the sale of those future profits.

F – Inter-Company Dividends

(i) Where shareholder is a Closely-held Corporation:

4.55 The government proposes to restrict the credit to shareholders of Canadian corporations by reference to the Canadian corporate tax actually paid by their corporations. To do this the government must have a more exact method of passing credit for Canadian corporate tax through a chain of corporations. Moreover, the decision to tax capital gains on disposal of shares requires that a more precise method be found for giving credit for corporate tax. Otherwise corporate shareholders could choose to receive tax-free dividends and then to sell their shares, thereby avoiding entirely the tax which would otherwise have been levied on the gain realized on the sale of their shares.

4.56 A closely-held Canadian corporation would be treated in exactly the same manner as would an individual shareholder in receiving credit for corporate tax. Specifically, it would take into its taxable income both the dividend and the taxable credit, and would claim the creditable tax as a deduction against the corporate tax which it would otherwise pay. The following table illustrates how this system would work.

Dividend received:		
From another closely-held Canadian corporation	$100	
From a widely-held Canadian corporation		$100
Plus taxable credit	100	50
Taxable amount	200	150
Gross tax	100	75
Less credit	100	50
Net tax	0	25
Amount available for distribution to its shareholders (dividend minus net tax)	100	75
Creditable tax available (gross tax amount)	$100	$ 75

(ii) Where shareholder is a Widely-held Corporation receiving dividends from a Closely-held Corporation:

4.57 A widely-held Canadian corporation receiving a dividend from a closely-held Canadian corporation would be taxed on the dividend in the same way that it is taxed on other income. Specifically, the corporation receiving a dividend of $100 from a closely-held Canadian corporation would take into its income for tax purposes $200 and claim as a deduction from the corporate tax it would otherwise pay the $100 corporation tax paid by the first corporation. In effect the dividend would have been received tax-free in this situation. However, if the corporation that pays the dividend has not paid sufficient corporation tax to Canadian governments to cover the dividend, the receiving corporation would have some net tax to pay.

4.58 When the receiving corporation pays a dividend to its shareholders it would instruct them to add to the dividend for purposes of the tax calculation only half of the corporation tax levied on it. The schedule set out below illustrates this procedure. The effect is that shareholders of Canadian public corporations receive credit for half, and only for half, of the corporation tax paid on the profits from which their corporation pays its dividends. This is true whether the profits are earned in a subsidiary corporation or in the public corporation itself.

Dividend received	$100	$100
Plus taxable credit:		
Assuming the payor corporation had enough creditable tax	100	
Assuming that it did not have enough, say 4/5ths		80
Taxable amount	200	180
Gross tax	100	90
Less credit	100	80
Net tax	0	10
Amount available for distribution to its shareholders (dividend minus net tax)	100	90
Creditable tax available (half of gross tax amount)	$ 50	$ 45

(iii) Where shareholder is a Canadian public company receiving dividends from another Canadian public company:

4.59 Special rules are needed to cover the case of a public corporation which receives a dividend from another public corporation. If the dividend were taxable at normal corporate rates, the effect would be to collect more corporate tax in those instances where there are intercorporate holdings than in those instances where the individual shareholder holds his share in the operating corporation in his own name. To overcome this shortcoming it is proposed that a special tax rate be applied to the dividends received by Canadian public corporations from other Canadian public corporations. The rate would be 33⅓ per cent so that this type of intercorporate dividend would be tax-free provided the corporation paying the dividend had paid sufficient Canadian corporate tax to cover the dividend. This special rate would also be applied to capital gains realized by one Canadian public corporation on the sale of shares in another Canadian public corporation. Finally, the loss suffered by one Canadian public corporation on the sale of a share in another Canadian public corporation would reduce tax only at this special rate. The effect of this rate on dividends passing through an intercorporate chain is illustrated in the following schedule:

	Corporate Chain	*Direct Ownership*
Dividend paid by public corporation No. 1	$100	$100
Public corporation No. 2		
Dividend received	100	
Plus taxable credit	50	
Taxable amount	150	
Gross tax, at 33⅓%	50	
Less credit	50	
Net tax	0	
Amount available for distribution	100	
Creditable tax (gross tax amount)	$ 50	
Individual shareholder		
Dividend received	$100	$100
Taxable credit	$ 50	$ 50

G – Where Shareholder is a Pension Fund or Mutual Fund

4.60 The government does not propose a refund to pension plans and other tax-free entities of the corporate tax paid by the corporations from which they receive their dividends. It considers that tax-free status of the investment income of the pension plan, including capital gains, is sufficient tax concession to these entities.

Shares held by Mutual Funds

4.61 Open-end mutual funds and most closed-end mutual funds would be widely-held corporations under the definitions proposed earlier in this chapter. As a result shareholders would receive the dividends that flow through the mutual fund subject to the same tax as if they had received the dividends directly. There is one exception to this, in the case of dividends from a closely-held corporation that are routed through a mutual fund. In this instance the government feels it appropriate to levy the same taxes on this portion of the corporate income as if the earnings had been in a public corporation. The relationship of the shareholder of the mutual fund to his corporation is much the same as that of shareholders of other public corporations to their corporations.

4.62 A special rule would, however, be required for mutual funds. This type of corporation must be able to put its shareholders in the same position as if they themselves had realized their proportion of the capital gains of the mutual fund arising on the sale of shares in public Canadian corporations. In the absence of a special provision mutual fund shareholders would pay tax on the full amount of such gains when they were distributed to them, whereas tax should be applied only to half of the gain. Consequently this type of corporation would be enabled to make special distributions to its shareholders which would be treated as though they were a capital gain on the sale of a Canadian public corporation.

In summary, to solve the problem of surplus accumulations of closely-held corporations, the authors of the White Paper have proposed that Canada:

(1) Adopt a procedure of grossing-up dividends that has recently been abandoned by Great Britain as being unrealistic and inhibitive to the growth of industry.

(2) Increase the taxes payable by all Canadian corporations, and deny all tax incentives.

(3) Place a compulsion on all Canadian corporations to distribute earnings annually instead of plowing them back for future expansion.

(4) Grant a dividend tax credit to shareholders that in some instances will be greater than the present 20% Canadian dividend credit, but in many other instances will be less.

Chapter 4

SPECIAL STUDY NO. 4

GROSSING-UP OF CANADIAN DIVIDENDS

STARTING UP THE PROPOSED SYSTEM

(A) With Respect to Closely-Held Corporations:

The authors of the White Paper are very explicit respecting the taxation of the surplus of a closely-held corporation that was accumulated before the White Paper proposals become law. The rules for taxation proposed in the Paper are:

(1) Distributions of undistributed income accumulated before this date must first be subjected to a 15% tax payable by the company. Assuming that such earnings have already borne Canadian and provincial income taxes of about 52%, this means that any distributions made out of the remaining undistributed 48% of the earnings must bear a tax of 15%. There is therefore an effective rate of tax of about 59.2% of every dollar of income earned by a closely-held corporation.

(2) Then, when the remaining 85% of the undistributed income on hand at the effective date is distributed to shareholders, the amounts received by the shareholders must not be treated as tax-free income, but instead must be applied by the shareholder to reduce the value of the shares of the closely-held corporation established on the valuation day. This means that a potentially increased capital gain may be realized and taxed if that shareholder ever sells his shares in the closely-held corporation.

(3) Closely-held corporations would be given the right to elect that earlier distributions to shareholders made after the adoption of the new system were dividends paid out of existing undistributed income, and so subject to the 15% tax and treated as a reduction of the value of the shares.

It is important to remember that shareholders of closely-held corporations will only be entitled to receive dividend tax credits on dividends paid after the new system is adopted, if such dividends are paid within 2½ years from the end of the corporation's taxation year. (Paragraph 4.27)

(4) No reference is made to surplus accumulations, other than undistributed income, existing before the effective date of the new system. It therefore must be assumed that such distributions would be taxed in full in the hands of the shareholders without the benefit of any dividend tax credit.

It may be easier to understand the implications of these proposals by reference to an arithmetic example, which contrasts the taxes payable on surplus accumulations under our present system, and the taxes payable under the proposals referred to above.

Example of Closely-Held Corporation owned by an Individual

(1) Assume that the balance sheet of a closely-held Canadian manufacturing corporation at a date prior to the adoption of the White Paper proposals could be summarized somewhat as follows:

Cash and receivables		$ 75,000	
Inventories - Valued at cost		45,000	$ 120,000
Factory Equipment - Valued at cost	900,000		
Less recorded depreciation	360,000	540,000	
(Undepreciated capital cost $370,000)			
Building - Valued at cost	500,000		
Less recorded depreciation	100,000	400,000	
(Undepreciated capital cost $200,000)			
Land - Valued at cost		50,000	990,000
			1,110,000
Less:			
Current liabilities		60,000	
Mortgage payable		205,000	265,000
Net assets, represented by:			
Common capital stock		75,000	
Earned surplus (Undistributed income $200,000)		770,000	$ 845,000

It may be stated that there are few, if any companies in Canada today, whose earned surplus shown on the financial statements does not exceed undistributed income computed for tax purposes. This latter sum is rarely if ever shown on the financial statements.

(2) Assume also that the fair market value of the common capital stock, based on an excellent record of earnings in past years, was about $1,000,000.

(3) Assume that the shares of this company were owned by an individual and that he wished to distribute the existing surplus of $770,000, and then lend the proceeds of this distribution back to the company to enable it to continue operations.

Under the present Income Tax Act this shareholder could cause the company to pay an income tax of 15% of the undistributed income of $200,000, totalling $30,000, or alternatively to pay a tax of 16-2/3% of $200,000, totalling $33,300, utilizing the various subdivisions of Section 105 of the Act. In either event he could withdraw the residue of the earned surplus of $770,000, less $30,000 or $33,000, free of tax.

Accordingly, by taking this action under our present tax laws, this shareholder would

(a) continue to own all the common stock of a company that had a book value of $75,000 and might be worth $1,000,000 on the basis of past earnings.

The balance sheet of the company after the distribution could be summarized somewhat as follows:

Cash and Receivables	$ 45,000	
Inventories	45,000	$ 90,000
Fixed assets - valued at cost less recorded depreciation		990,000
		1,080,000
Less:		
Current liabilities	60,000	
Mortgage payable	205,000	265,000
		815,000
Less:		
Loan from shareholder - probably subordinated to all other creditors		740,000
Net assets, represented by Common capital stock		$ 75,000

(b) have a loan payable to himself by the company of $740,000.

So, by arranging to have the company pay a tax of from $30,000 to $33,000, the shareholder could remove the remaining accumulated surplus of $740,000 free of further tax under the provisions of our present Income Tax Act.

If the shareholder should fail to take any action before the adoption of the White Paper tax proposals, and then wished to withdraw the accumulated surplus of $770,000, after the proposals had become law, the tax position would be changed drastically. It would be as follows:

(1) A tax of 15% of the existing undistributed income of $200,000 or $30,000, would become payable by the company.

(2) The residue of $170,000 of undistributed income would have to be applied to reduce the value of the common shares from $1,000,000 to $830,000. This would produce a potential taxable capital gain of $170,000 if the shareholder were ever able to sell his shares for the earnings value of $1,000,000.

(3) The other accumulated surplus of $570,000 would be taxed in the hands of the shareholder without the benefit of any dividend tax credit, so that the tax payable by him would be at least $285,000.

(4) The balance sheet of the company would be the same as that referred to previously, except that the loan from the shareholder would be substantially reduced because of tax payments.

Accordingly, after the proposed system has become law,

(a) the company would pay a tax of $30,000 and the shareholder would pay a personal tax of at least $285,000 on distributions made to him, and

(b) the shareholder would face a potential tax of $85,000 on a capital gain of $170,000 on the eventual sale of the shares of the company.

Therefore the taxes payable under the present system would be about $30,000 to $33,000 compared to the taxes of about $400,000 payable under the proposed tax system, both based upon an identical amount of surplus.

It may be observed that it is the reluctance of shareholders of closely-held corporations to pay taxes equivalent to the $30,000 to $33,000 referred to above which has resulted in the tax problems respecting accumulations of surplus by closely-held companies. It would appear that they are now to be compelled to pay very much increased taxes on existing surplus to be able to qualify for a different type of dividend tax credit.

Example of a Closely-Held Corporation that is a Subsidiary of a Widely-Held Corporation

If the closely-held manufacturing company already referred to were the wholly-owned subsidiary of a Canadian widely-held corporation, instead of being owned by a single individual, the position would be somewhat as follows.

Under our present tax laws the accumulated surplus of $770,000 could be paid free of tax to the parent corporation and would become accumulated undistributed income of the widely-held parent company. If and when dividends were distributed by the parent company to its shareholders they would be taxed thereon and entitled to claim the 20% Canadian dividend credit.

Under the proposed tax laws:

(1) The closely-held subsidiary company would have to pay a 15% tax of $30,000 on the undistributed income of $200,000.

(2) The residue of the undistributed income of $170,000 would have to be applied by the parent company to reduce the value of the shares of the closely-held corporation, thereby producing a potential taxable capital gain of $170,000.

(3) The parent company would have to pay a 50% tax on the dividend of $570,000 paid by the subsidiary company out of surplus that was not undistributed income accumulated prior to the adoption of the White Paper proposals.

It is difficult to believe that the foregoing results were deliberately planned by the authors of the White Paper, but they are the inescapable conclusions to be drawn from the explanation and example contained in Paragraphs 4.74 to 4.79 of the White Paper.

The arithmetic example contained in Paragraphs 4.75 to 4.77 of the White Paper is based on four assumptions that are:

(a) the depreciated book value of the building of $300,000 is the same as its undepreciated capital cost;

(b) the accumulated earnings of $70,000 are the same as its undistributed income;

(c) the value of the shares of the company is based solely on the value of the tangible assets less liabilities; and

(d) the company is wound up immediately after the sale of its building.

It is doubtful that all these assumptions will ever occur together, so that the conclusions of this example are of a specific nature and may not have general application.

(B) With Respect to Widely-Held Corporations:

The White Paper is silent respecting surplus of a widely-held corporation that had been accumulated prior to the date the proposals become law.

If the reasoning set out in the White Paper is to be applied consistently, it would appear that dividends paid out of such surplus to shareholders by a widely-held corporation will be taxed in full in the hands of the shareholders without the benefit of any dividend tax credit. It may also be that the existing 20% Canadian dividend credit that would otherwise apply will also be denied to such shareholders.

It should also be observed that widely-held corporations apparently also must distribute dividends within 2½ years of the end of the fiscal year in which the earnings were realized in order that the shareholders be entitled to the dividend tax credit. (Paragraph 4.37)

In summary it would appear that the adoption of these proposals will impose a fearful tax cost on Canadian shareholders so that they may some day achieve the benefits of harmony or integration of corporation and individual income taxes.

SPECIAL STUDY NO. 4

GROSSING-UP OF CANADIAN DIVIDENDS

POSSIBLE ALTERNATIVES

Having considered the proposals contained in the White Paper respecting corporation taxes and dividends paid to Canadian shareholders, your Advisor suggests for your consideration that it may not really be necessary to revise the taxation system of the entire country to solve one specific problem.

The problem to be solved relates solely to the accumulations of surplus by closely-held corporations.

Accordingly could not this problem be solved both for the present and the future by:

(a) Defining what a closely-held corporation is considered to be.

(b) Providing that the surplus accumulations of such corporations may be distributed free of tax at any time. Alternatively, if it be felt some tax must be collected thereon, consider imposing a nominal tax of say 3%, which the shareholder will find cheaper to pay than to seek to avoid.

(c) Leaving present federal and provincial corporation tax rates undisturbed.

(d) Leaving the present 20% Canadian dividend credit undisturbed.

The foregoing proposals will not affect the revenues of the country.

APPENDIX I

SPECIAL STUDY NO. 5

TAXATION OF SMALL BUSINESSES

Under our present tax system every company, no matter how large or small its taxable income may be, pays an annual income tax of:

(1) 18% Income tax and 3% Old Age Security tax of the first $35,000 of taxable income, plus a temporary surtax of 3% of 18%. This produces an effective tax rate of 21.54% of the first $35,000 of taxable income.

(2) 47% Income tax and 3% Old Age Security tax, plus a temporary surtax of 3% of 47% of taxable income in excess of $35,000. This produces an effective rate of 51.41% of taxable income in excess of $35,000.

(3) An additional provincial income tax where a province levies a provincial income tax in excess of 10%. By way of illustration, this extra provincial tax is 2% in the case of Quebec and Ottawa, both of which levy corporation taxes of 12%.

The effect of the foregoing is that every corporation or group of associated corporations pays a tax of 21.54% on $35,000 of taxable income of $35,000 as compared to a tax of 51.41% on the balance of taxable income. This is an annual reduction in tax of $10,454.50 granted every such corporation, no matter how large or small its taxable income may be.

It is conceded by all that the restoration of Ministerial Discretion to the Income Tax Act in June, 1963, as it relates to Associated Companies, has prevented a single company from subdividing its business operations into several subsidiary company operations so as to increase the number of $35,000 amounts on which it pays tax of 21.54%. It also ensures that an existing group of companies is entitled to pay tax of 21.54% on only one amount of $35,000.

On February 11, 1970 the Minister of Finance advised your Committee that the number of Canadian companies that pay tax and their taxable income is as follows:

Taxable Income Range	No. of Companies
\$ 1 to \$ 1,999	18,612
2,000 to 4,999	15,523
5,000 to 9,999	15,521
10,000 to 19,999	16,356
20,000 to 34,999	15,354
	81,366
Over \$35,000	10,913
	92,279

It is interesting to observe that of the 200,000 and more Canadian corporations that file annual income tax returns, in 1967

81,366 corporations had taxable income of less than \$35,000

10,913 corporations had taxable income of over \$35,000

92,279

Further, the average taxable income of the 81,366 smaller corporations was \$10,399. The average taxable income of the 10,913 larger corporations was \$350,902.

Comparable federal taxes in the United States are:

(i) The normal tax rate on all taxable income of a corporation is 22%.

(ii) There is a surtax of 26% on taxable income in excess of \$25,000. Accordingly taxable income in excess of \$25,000 is taxed at 48%. (A surcharge of 10% for the year 1970 has been added to the above).

The following table contrasts the provisions of the present Income Tax Act and the White Paper proposals:

Present Tax Law

Section 39-1

This section provides that corporations shall pay an annual income tax of
(i) 21% of the first $35,000 of taxable income, and

(ii) 50% of excess taxable income.

Section 39-2 to Section 39-7

This complicated legislation define associated companies and provide that when two or more companies are associated, such group of associated companies is only entitled to pay the rate of 21% on one amount of $35,000.

Sections 138A-2 and 138A-3

These sections give the Minister of National Revenue the power to exercise Ministerial Discretion to hold that two or more companies are associated even though they are not in fact associated for purposes of Section 39-2.

White Paper Proposals

1.39 The government proposes to alter the method of taxing corporations by establishing a single rate of corporation tax and providing a system of credits to shareholders for corporate taxes paid. An important distinction would be made between private, closely-held corporations and public, widely-held corporations.

1.40 For closely-held corporations, which are usually smaller businesses managed by the shareholders, the tax should be related as closely as possible to rates paid by individual shareholders. There is usually a close identity between the shareholders and the corporation. These corporations usually compete in markets with unincorporated businesses subject only to personal income tax. Under the proposed plan the federal income tax paid by such corporations would be treated as a prepayment of the personal income tax on behalf of individual resident shareholders. Under certain conditions the corporation could elect to be taxed as a partnership of its shareholders. In other cases the shareholders would pay tax on a sum that includes their dividends plus a related amount of corporate tax already paid; and they would then claim credit for the corporate tax paid, and qualify for a refund if their own rates are lower than the corporate rate.

1.41 The government believes that this is a fairer way of taxing the income of Canadians which flows through corporations than the existing system with its lower rate of corporate tax on $35,000 of profits annually. It proposes to remove this lower rate gradually over a period of five years. Thereafter, the benefits of low rates of tax would go to shareholders with small incomes rather than to corporations with small incomes.

1.44 This new system would:
- offer a substantial inducement for Canadians to invest in Canadian business;
- when combined with the proposed method of taxing capital gains, make possible a fair and fully effective but economically tolerable tax system;
- prevent surplus stripping and most other tax avoidance devices;
- be fairer in its treatment of lower-income shareholders than the present dividend tax credit and preferred low rate of tax on the first $35,000 of corporate income.

8.25 The main change, of course, is the gradual reduction over five years of the amount of corporate income subject to the 21-per-cent rate of tax. This would increase the yield of the federal corporation income tax by an estimated $95 million in 1969 if that were the first year of the new system and $390 million if it were the fifth year.

White Paper Proposals

4.24 In the case of those corporations which are not to be treated as partnerships, parity with the shareholders of partnership corporations would be achieved in two steps. There would be a tax of 50 per cent on the taxable income of the corporation. However, when the net profits are distributed to the shareholders, credit would be given for the full amount of the tax paid by the corporation on those profits.

4.28 The government believes this is a fairer way of dealing with the income of Canadians flowing through closely-held corporations. In effect, the present system gives an arbitrary concession to small corporations. The proposed system would graduate the tax according to the circumstances of the shareholder. Therefore the benefit would go to shareholders with small incomes rather than to corporations with small incomes.

4.29 While the government believes this system is much fairer than the present one, it must be acknowledged that it would substantially increase the taxes to be borne by existing small corporations, and many of these corporations may have made financial commitments based upon the present tax system and the after-tax income they can expect under the system.

4.30 It is therefore proposed that the low rate be removed from the business profits of small corporations gradually over a period of five years. For corporations with taxable business profits not greater than $35,000 the low rate would apply to $28,000 in the first year of transition, $21,000 in the second, $14,000 in the third, $7,000 in the fourth, and be eliminated entirely in the fifth year. For corporations with taxable business profits above $35,000, the amount subject to the low rate would be reduced more quickly the more the corporation's taxable profits exceed $35,000. The benefit would be removed immediately if taxable business profits equal or exceed $105,000. In other words, the larger the corporation the more quickly it would lose the benefit designed for small corporations.

White Paper Proposals

4.31 The precise formula would remove 80 cents of a corporation's entitlement to be taxed at the low rate for each $2 of business income in excess of $35,000 in the first year of transition. In the second year the reduction would be 60 cents for each $2; in the third year, 40 cents for each $2; and in the fourth year, 20 cents for each $2. In the meantime the maximum entitlement would be reduced, so that the effect would be a gradual reduction in the amounts subject to the low rate of tax. For example, a company with taxable business profits of $85,000 in each of the first five years of the new system would be entitled to have $8,000 taxed at the low rate in the first year, $6,000 in the second year, $4,000 in the third year, $2,000 in the fourth year and nothing the fifth year. On the other hand, a corporation that earns $45,000 in each of the first five years would be entitled to have $24,000, $18,000, $12,000, $6,000 and zero taxed at the low rates.

4.32 Taken together these proposals concerning closely-held corporations should provide a tax system with the same effect on business carried out through such a corporation as on business carried on through a proprietorship. It should also collect the same tax on the investment income of a Canadian individual whether he holds his investments directly, or whether he holds them through a personal holding corporation.

4.33 Meanwhile gains realized on the sale of shares in closely-held corporations would be taxed as ordinary income, and losses suffered on the sale of such shares would be deductible from other income for tax purposes. When coupled with the system of full integration, this would mean that the tax effects would be the same whether an individual causes his corporation to sell its assets to a prospective purchaser or chooses to sell his shares to that purchaser, thereby giving the purchaser indirect control of the assets.

The proposals contained in the White Paper appear designed to accomplish two objectives, which are:

(A) To increase taxes payable by corporations. It is estimated that by the fifth year of operation of the proposals this increased tax will be $390M. This seems to imply that about 37,700 Canadian companies or groups of associated companies will be effected; and

(B) To require all Canadian companies to pay an income tax of 50% to ensure that shareholders will be entitled to claim a tax credit in respect of any dividends they may receive from such corporations. At present all shareholders are entitled to a tax credit of 20% of the dividend received, no matter what the effective rate of tax paid by the corporation may be.

A corporation that carries on a smaller business operation is almost always a closely-held corporation. Therefore to ensure that its shareholders will receive dividends free of tax, if and when the company is able to pay them, the company is required to pay an additional annual tax of about $10,354. No regard is apparently had to the ability of the company to expand.

Comments

It would seem that the smaller businesses could still be protected by:

(1) Defining a small business to be one whose taxable income in a year does not exceed some amount, such as $50,000, $75,000 or $100,000.

(2) Allowing a small business, as defined to claim a lower rate of tax on the first $35,000 of taxable income.

Members of the Committee should realize that any change made in the proposed overall 50% rate of corporation tax will affect the harmony or integration of corporation and income taxes that the authors of the White Paper are seeking to achieve.

SCHEDULE SHOWING INCREASED
CORPORATION TAXES PAYABLE BY CORPORATIONS
(Based on Information Supplied by
Minister of Finance under date of February 11, 1970)

If the White Paper proposals to eliminate the lower rate of tax on the first $35,000 of taxable income become law, the increased taxes payable by all corporations five years after the adoption of the proposals will be:

Taxable Income Range	No. of Companies	Average Taxable Income	Increased Tax 51.41% less 21.54%
$ 1 to $ 1,999	18,612	$ 830	5 M
2,000 to 4,999	15,523	3,326	15 M
5,000 to 9,999	15,521	7,236	34 M
10,000 to 19,999	16,356	14,323	70 M
20,000 to 34,999	15,354	28,166	129 M
	81,366	10,399	253 M
35,000 and up	10,913	350,902	114 M
	92,279		
Total increased taxes, if maximum rates of tax remain at present rates of tax of 51.41%			367 M
Less reduction in increased taxes if maximum rate is reduced to 50% (40% federal 10% provincial) five years hence			65 M
Total increased taxes five years hence, payable by companies			
(i) whose taxable income is less than $35,000		241 M	
(ii) whose taxable income is $35,000 and up		61 M	302 M

It is interesting to observe that the increased taxes collectible from corporations as the result of the elimination of the lower rate of tax on the first $35,000 of taxable income will be payable by:

	No. of Companies	If Maximum Rate is 51.41%	If Maximum Rate is 50%
Taxable incomes of less than $35,000	81,366	$ 253 M	$ 241 M
Taxable incomes of $35,000 and over	10,913	114 M	61 M
	92,279	$ 367 M	$ 302 M

The White Paper estimates that the increased taxes five years hence will be \$390 M (Paragraph 8.25). The information supplied by the Minister of Finance is based on 1967 statistics. It is possible that the authors of the White Paper have estimated that an increase in the number of taxable corporations and taxable incomes will occur in future years.

Second Session—Twenty-eighth Parliament
1969-70

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE
ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 12

WEDNESDAY, MARCH 18th, 1970

Complete Proceedings on Bills C-133, C-134, C-175 and C-183,
intituled respectively:

"An Act to repeal the Deep Sea Fisheries Act";
"An Act to amend the Coastal Fisheries Protection Act";
"An Act to establish the Canadian Saltfish Corporation and regulate interprovincial and export trade in saltfish in order to improve the earnings of primary producers of cured cod fish"; and
"An Act to amend the Agricultural Products Co-operative Marketing Act".

WITNESSES:

Department of Fisheries and Forestry; (Fisheries Service): Dr. R. R. Logie, Assistant Deputy Minister; W. C. MacKenzie, Director, Economic Branch. *Department of Agriculture:* C. R. Phillips, Director-General, Production and Marketing Branch.

REPORTS OF THE COMMITTEE

21638—1

THE STANDING SENATE COMMITTEE ON

BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aseltine,	Desruisseaux,	Kinley,
Beaubien,	Everett,	Lang,
Benidickson,	Gélinas,	Leonard,
Blois,	Giguère,	Macnaughton,
Burchill,	Grosart,	Molson,
Carter,	Haig,	Phillips (*Rigaud*),
Choquette,	Hayden,	Walker,
Connolly (*Ottawa West*),	Hays,	Welch,
Cook,	Hollett,	White,
Croll,	Isnor,	Willis—(30)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, March 10, 1970:

"Pursuant to the Order of the Day, the Senate resumed the debate on the motion of the Honourable Senator Burchill, seconded by the Honourable Senator Boucher, for the second reading of the Bill C-133, intituled: "An Act to repeal the Deep Sea Fisheries Act".

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative, on division.

The Bill was then read the second time, on division.

The Honourable Senator Burchill moved, seconded by the Honourable Senator Boucher, that the Bill be referred to the Standing Senate Committee on Banking, Trade and Commerce.

The question being put on the motion, it was—

Resolved in the affirmative."

Extracts of the Minutes of the Proceedings of the Senate, March 12, 1970:

"Pursuant to the Order of the Day, the Honourable Senator Smith moved, seconded by the Honourable Senator McDonald, that the Bill C-134, intituled: "An Act to amend the Coastal Fisheries Protection Act", be read the second time.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative.

The bill was then read the second time.

The Honourable Senator Smith moved, seconded by the Honourable Senator Isnor, that the Bill be referred to the Standing Senate Committee on Banking, Trade and Commerce.

The question being put on the motion, it was—

Resolved in the affirmative."

"Pursuant to the Order of the Day, the Senate resumed the debate on the motion of the Honourable Senator Petten, seconded by the Honourable Senator Eudes, for the second reading of the Bill C-175, intituled: "An Act to establish the Canadian Saltfish Corporation and regulate interprovincial and export trade in saltfish in order to improve the earnings of primary producers of cured cod fish".

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative.

The bill was then read the second time.

The Honourable Senator McDonald moved, seconded by the Honourable Senator Smith, that the Bill be referred to the Standing Senate Committee on Banking, Trade and Commerce.

The question being put on the motion, it was—
Resolved in the affirmative.

Extract from the Minutes of the Proceedings of the Senate, March 17, 1970:

"The Order of the Day being read,
With leave of the Senate,

The Honourable Senator Pearson resumed the debate on the motion of the Honourable Senator Argue, seconded by the Honourable Senator Duggan, for the second reading of the Bill C-183, intituled: "An Act to amend the Agricultural Products Co-operative Marketing Act".

After debate, and—
The question being put on the motion, it was—

Resolved in the affirmative.
The Bill was then read the second time.
The Honourable Senator Argue moved, seconded by the Honourable

Senator Duggan, that the Bill be referred to the Standing Senate Committee on Banking, Trade and Commerce.

The question being put on the motion, it was—
Resolved in the affirmative."

ROBERT FORTIER,
Clerk of the Senate.

MINUTES OF PROCEEDINGS

WEDNESDAY, March 18th, 1970.
(16)

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m.

Present: The Honourable Senators Hayden (*Chairman*), Aseltine, Beaubien, Blois, Carter, Cook, Desruisseaux, Flynn, Everett, Gelinas, Haig, Hollett, Isnor, Kinley, Leonard, Macnaughton, Martin, Phillips (*Rigaud*) and Welch—(19).

Present, but not of the Committee: The Honourable Senators Laird, McDonald, Smith and Sullivan—(4).

In attendance: E. Russell Hopkins, Law Clerk and Parliamentary Counsel.

The following Bills were examined:

Bill C-133, "An Act to repeal the Deep Sea Fisheries Act";

—and—

Bill C-134, "An Act to amend the Coastal Fisheries Protection Act."

The following witness was heard:

Department of Fisheries and Forestry; (Fisheries Service);

Dr. R. R. Logie,
Assistant Deputy Minister.

Upon motions it was Resolved to report the said Bills without amendment.

Bill C-175, "An Act to establish the Canadian Saltfish Corporation and regulate interprovincial and export trade in saltfish in order to improve the earnings of primary producers of cured cod fish."

The following witness was heard:

Department of Fisheries and Forestry; (Fisheries Service);

Mr. W. C. MacKenzie,
Director, Economic Branch.

Upon motion to Report the said Bill without amendment, the Committee divided as follows:

YEAS—7 NAYS—3

The motion was declared *carried.*

Bill C-183, "An Act to amend the Agricultural Products Co-operative Marketing Act."

The following witness was heard:

Department of Agriculture;

Mr. C. R. Phillips,
Director-General,
Production and Marketing Branch.

Upon motion it was Resolved to report the said Bill without amendment.

At 10:15 a.m. the Committee proceeded to the next order of business.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

REPORTS OF THE COMMITTEE

WEDNESDAY, March 18th, 1970.

The Standing Senate Committee on Banking, Trade and Commerce to which was referred the Bill C-133, intituled: "An Act to repeal the Deep Sea Fisheries Act", has in obedience to the order of reference of March 10th, 1970, examined the said Bill and now reports the same without amendment.

Respectfully submitted.

Salter A. Hayden,
Chairman.

WEDNESDAY, March 18th, 1970.

The Standing Senate Committee on Banking, Trade and Commerce to which was referred the Bill C-134, intituled: "An Act to amend the Coastal Fisheries Protection Act", has in obedience to the order of reference of March 12th, 1970, examined the said Bill and now reports the same without amendment.

Respectfully submitted.

Salter A. Hayden,
Chairman.

WEDNESDAY, March 18th, 1970.

The Standing Senate Committee on Banking, Trade and Commerce to which was referred the Bill C-175, intituled: "An Act to establish the Canadian Saltfish Corporation and regulate interprovincial and export trade in saltfish in order to improve the earnings of primary producers of cured cod fish", has in obedience to the order of reference of March 12th, 1970, examined the said Bill and now reports the same without amendment.

Respectfully submitted.

Salter A. Hayden,
Chairman.

WEDNESDAY, March 18th, 1970.

The Standing Senate Committee on Banking, Trade and Commerce to which was referred the Bill C-183, intituled: "An Act to amend the Agricultural Products Co-operative Marketing Act", has in obedience to the order of reference of March 17th, 1970, examined the said Bill and now reports the same without amendment.

Respectfully submitted.

Salter A. Hayden,
Chairman.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Ottawa, Wednesday, March 18, 1970

The Standing Senate Committee on Banking, Trade and Commerce, to which was referred Bill C-133, to repeal the Deep Sea Fisheries Act; Bill C-134, to amend the Coastal Fisheries Protection Act; Bill C-175, to establish the Canadian Saltfish Corporation, and Bill C-183, to amend the Agricultural Products Co-operative Marketing Act, met this day at 9 a.m. to give consideration to the said bills.

Senator Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: Honourable senators, we have several public bills to deal with and then we have two submissions to hear on the White Paper. The first bill is C-133, which is to repeal the Deep Sea Fisheries Act. Dr. R. R. Logie, Assistant Deputy Minister, Department of Fisheries and Forestry, will answer any questions you may have.

Senator Hollett: Mr. Chairman, would you tell me exactly what is meant by this explanatory note:

> It is considered that the payment of such bounties is no longer appropriate to present day circumstances...

I visualize certain crews with four or five members of one family in the boat, which means that they would get anywhere from $10 to $15 apiece if absolutely essential. I think that is appropriate under the present circumstances. What are you going to do in a case such as that?

Dr. R. R. Logie, Assistant Deputy Minister (Fisheries Service), Department of Fisheries and Forestry: Mr. Chairman, the original purpose of the Deep Sea Fisheries Act was to improve the fisheries.

Senator Hollett: This was a grant from the American Government and they did not care whether or not they approved our fisheries. The Government of the day decided that instead of paying out the money to the fishermen at that particular time they would pay it out at an interest rate of 3 or 4 per cent.

The Chairman: Let us see if we are talking about the same thing.

Dr. Logie: This bill proposes to repeal the Deep Sea Fisheries Act, which is a Canadian statute.

Senator Hollett: I know that.

The Chairman: In the opening section 2 of the act, which is being repealed, it says:

> The Governor in Council may authorize the payment, out of the Consolidated Revenue Fund of Canada, of an annual grant not exceeding one hundred and sixty thousand dollars, to aid in the development of the sea fisheries of Canada, and the encouragement of the building and fitting out of improved fishing vessels, and the improvement of the condition of the fishermen.

And section 3:

> Such grant shall be appropriated for the said purposes at such times and by such instalments in each year, as the Governor in Council directs.

Now, there the scope of the bill is being revealed.

Senator Hollett: Did I understand that that $160,000 was approximately the interest on the $4,500,000 paid by the American government? Or am I talking about the wrong act?

Dr. Logie: No, I think you are right, sir. It was calculated originally at 3½ per cent, or something like that, but the appropriation of $160,000, which was originally $150,000, has been a flat appropriation for years. I think it relates back to the interest.

Senator Hollett: Ever since 1888, if I remember right. Why is the appropriation now cut off? I can see certain families doing very well out of it as a means of assistance.

The Chairman: The question, Dr. Logie, is why is the bill being repealed?

Dr. Logie: The answer is, sir, that the government's position is that there have been other acts enacted, for example, the Fisheries Development Act and other aid developments which have replaced it. The position is that, if the purpose of this $160,000 is to aid in the development of the sea fisheries of Canada and the building of fishing vessels, this act is really anachronistic. In terms of how much $10 might mean to an individual fishing family, which is the way it has been used, that is perhaps another question, but in respect of aiding in the development of the sea fisheries of Canada there is now other more effective legislation.

Senator Hollett: You may be right that it is more effective, but here you are taking away something which for over a period of 50 or 60 years fishermen have been in the habit of receiving.

Senator Carter: I think the point of Senator Hollett's remarks is that the original purpose of this act was not to improve fisheries, but you are talking about improving fisheries and that there is other legislation to do it better than this so that we do not need this. Senator Hollett maintains that that was not the original purpose of this legislation.

The Chairman: I have read to you what section 2 of the act says, and that certainly indicates the purpose is to aid in the development of the sea fisheries of Canada and the encouragement of the building and fitting-out of improved fishing vessels and the improvement of the condition of the fisherman. Those are the three purposes.

Senator Hollett: Yes, the improvement of the conditions of the fishermen.

The Chairman: Yes. You say you have other and more effective means for the improvement of the condition of the fishermen. Will you tell us what those are?

Senator Hollett: Before going on to that, may I ask what happens if you repeal this act? What you intend now is for the Consolidated Revenue Fund to take possession of that $4½ million and do what they like with it, instead of carrying out the intention, over the years, of assisting by way of a bounty certain fishermen who had not done so well in a particular season. I do not see how any government can do that. The bank might just as well take the money and not pay you any interest on it.

The Chairman: There is nothing in the Deep Sea Fisheries Act which talks about $4 million. It simply charges the Consolidated Revenue Fund of Canada with the payment of an annual grant not exceeding $160,000.

Senator Hollett: But it was based on that grant.

The Chairman: That is what you say.

Senator Hollett: That is what they say in the House of Commons.

The Chairman: Well, is a reference to the House of Commons Debates like reading the Bible?

Senator Hollett: Reading the Bible?

The Chairman: Yes.

Senator Hollett: Well, it may not be Bible to you, but it is to the fishermen.

The Chairman: I am not talking about the fishermen. You are referring to the House of Commons *Hansard.*

Senator Hollett: I am referring to the explanation given by the Minister of Fisheries, or one of his assistants. The point that gets me is how a government can take from a group of fishermen along the Atlantic coast something they have been in the habit of receiving over the years—50, 60 or 70 years.

The Chairman: I have asked Dr. Logie to tell us what is the effect of the legislation that would replace this Act.

Dr. Logie: Well, our estimates have not been reduced by this amount of $160,000. So this would be spent finally through the Fisheries Development Act in future years. I don't have that act with me, but perhaps the senators are aware of it. It could do the things it says. It can be used in vessel subsidization, cold storage subsidization and other forms of assistance to the industry and it has been so used. I think the Government's position is that the handing out of $10 or so per fisherman has becom anachronistic in this light.

The Chairman: Are there any questions?

Senator Hollett: Personally, I think it is morally wrong, no matter what the Government says. However, I cannot do anything about it.

The Chairman: Honourable senators, in order to allow Senator Kinley, who is not

present at the moment, a chance to comment on this bill, perhaps it would be appropriate to deal with another bill.

Dr. Logie, can you tell us about Bill C-134, an act to amend the Coastal Fisheries Protection Act?

Dr. Logie: Yes, Mr. Chairman. That act gives to the Minister of Fisheries and Forestry and to the Government the power to have complete control over the entry of foreign fishing vessels into Canadian ports, and the amendment of substance includes for the first time vessels supplying the fisheries, such as water tankers and so on, which were not included before.

The Chairman: It involves the redefining of what a fishing vessel is, then?

Dr. Logie: That is right. The substantial change is in Section 2 (e) (iii).

The Chairman: Are there any questions on Bill C-134, or are you ready to report the bill without amendment?

Hon. Senators: Agreed.

The Chairman: There is a motion to report the bill without amendment. Carried.

As Senator Kinley has still not returned, we will pass on to Bill C-175, a bill to establish the Canadian Saltfish Corporation and regulate interprovincial and export trade in saltfish in order to improve the eranings of primary producers of cured codfish.

Mr. Mackenzie, will you give us a short statement explaining the purpose and scope of this bill, please?

Mr. W. C. Mackenzie, Director, Economic Branch, Department of Fisheries and Forestry): I will try to, Mr. Chairman. The bill has to be viewed as part of a combined program to improve the economic position of one segment of the Atlantic coast fishing industry. This is the segment that produces cured fish mostly cured codfish, and mostly, at this time, for the export trade. To the extent of about two-thirds, this product originates in the traditional fishing industry of Newfoundland and on the lower north shore of the Quebec province. By a traditional industry I mean that it is an industry in which the fisherman is also the processor. The product is derived from the inshore landings of the small boat fishery in this part of the Atlantic region. The product is produced in a finished or semifinished form, in both cases by small local fishing crews. It is collected by intermediaries of several classes and eventually finds its way through the export houses of St. John's, Halifax and some other ports.

The people involved in this part of the industry have been and are in an exceedingly depressed economic condition, and at the present time the meager incomes they do obtain are, by more than half the total extent of the cash income, supported by government sources. Less than half the cash income comes from their own occupations as fishermen and processors. This is on the average. So a great many rather intractable social problems stem from this, and a massive effort is being mounted to change the whole situation of these people by programs for their resettlement and re-employment over the next decade or two and to upgrade their productivity and the efficiency, and it is as part of this effort that this bill is to be applied. It is intended to stabilize prices for fishermen at what is hoped to be a higher level than has been the case in the past and it is hoped that the corporation may also help to consolidate and stabilize the internal trade in this product, that is the collection, handling, processing and shipping and so on of this product. By doing that, it is hoped to reduce the cost involved and as a result to maximize the price that the primary producer will receive.

The Chairman: Mr. Mackenzie, I notice in the purpose and powers of the corporation it is really being set up so that you will have one seller of cured fish which will be the corporation.

Mr. Mackenzie: It will have the power under this act to become the sole buyer and handler and exporter and seller of cured fish products. That refers to cod species and related species. In some provinces there may be some exemptions such as Gaspé-cured and Nova Scotia boneless cured which may be exempted from the control of the corporation. However, if the corporation proves to be a great success, it will be perfectly possible for these producers concerned with this product to opt in at a later stage.

Senator Kinley: Mr. Chairman, coming as I do from the largest fishing port on the Atlantic coast, this bill is of great interest to me. I have no objection to the principle of the bill, but I find that under the North British America Act the sale of manufactured goods and products of the country shall be freely sold throughout Canada, and this I think is an invasion of the British North America Act. In

fact it was Senator Lang who said that he thought this was encroaching on it and was against section 116. I am not sure if that is the appropriate section, but I think it is.

The Chairman: Are you referring to section 121?

Senator Kinley: Yes, I think that is the one.

The Chairman: May I read it so that everybody will know what you are talking about? It says:

> All Articles of the Growth, Produce or Manufacture of any one of the Provinces shall, from and after the Union, be admitted free into each of the other Provinces.

All that means is that they can move without Customs duties. Goods can move from one province to another without payment of Customs duties.

Senator Kinley: There was a discussion in the house last night on the delegation of authority, which would lead me to believe that it was a rather serious question in Canada. The situation with regard to the saltfish trade is something like the salt beef trade. In my younger days everybody had salt beef in the cellar and they cured it and it was good beef, but now it is not used as much as it was then. Newfoundland says that it is in a disadvantaged position with regard to fresh fish. I do not think this is so. Newfoundland is eminently well situated for the fresh fish trade, with refrigeration and so on, but what I don't like about this is that it is a monopoly. That is my first objection.

My second objection is that it is against the spirit of trade in Canada. My third objection is that as far as the economics of the situation go, we export more saltfish from Nova Scotia than they do from Newfoundland, and we buy 35 per cent of their production.

Now, with regard to the price for fish, it is 90 cent a pound, but of course it has no bones in it, like meat, and curing it is a long, slow process. Fresh fish is quicker and cleaner to deal with. I can give instances of very successful firms in Newfoundland who are in the business. The largest frim in Canada is National Sea Products of Lunenburg who have recently opened up a plant in Newfoundland and have spent a million dollars there. So that in the fresh fish trade Newfoundland is not carrying any sort of burden any more than any other part of the country. I admit in the saltfish business in the northern part of Newfoundland where they have no communications, there are problems. But I have an idea. As you know, they don't call beef that is salted, salt beef; they call it corned beef. I think these people in the back sections of Newfoundland can cure the fish and the fish flakes and produce a splendid product. The people of the Gaspé can also produce a splendid product, and their fish is known throughout the world. Of course there they have good air and the good sense to salt the fish in the way it is needed for each market. If you want slightly salted fish for one market and a more heavily salted fish for another market, you can get it from the Gaspé. Some of the areas of Newfoundland are still a little backward, but now they are getting better transportation and better facilities, and of course they get subsidies for boats around the coast. I do not object to this.

As I say, Mr. Chairman, I do not think we should have a monopoly in this where the situation could arise that Nova Scotia could not sell to Newfoundland or New Brunswick or could not export its own product to the world. The same situation would apply to New Brunswick and the Gaspé coast. It seems to me that this bill is against the spirit of free trade. However, if you say that is what it means, the time might come when they would ask for regional tariffs and some of these other things we do not like in Upper Canada. There are 60 firms in Nova Scotia in the saltfish trade and they are overnight from the Boston market. The green cured fish and fish cured in brine is very popular on the Boston market and they have got the highest price I have known for years, 45 cents per package. Senator Hollett tells us that the price of saltfish in Newfoundland was $35 a quintal. That is a splendid price. This situatiion is not like the grain business in the west because grain will keep while fish or fish products will not keep too long. So, the situation is different. However, we have got this trade in the United States and individuals there are doing very well because, as I told you, this is not according to price. This salt fish is nearly twice the price of fresh fish. It is something people have got used to. People learn to eat things when they are young and they want to eat them when they are older. So, people who eat salt fish are those who are used to it. There are also people coming from Europe and all over the world who are used to this kind of fish. And do not forget that if we close it up to the Atlantic provinces, St.

Pierre is just over the horizon and she will handle the fresh fish.

Our bigest competitor for the New York Market is Greenland. I do not say they are the biggest in quantity because the Americans give quotas to people who come in, and we have a fairly large quota, but the Greenlanders have a lower standard of living. The Norwegians have a lower standard of living too, and they are splendid fish operators and have a great fish trade and know their fish. They go so far as to say they freeze the fish the minute they catch it, so that it is good and wholesome.

I think we are taking a backward step. They had this in Newfoundland in the days of commission government; the commission government took control of the fish in Newfoundland. The senator who introduced this said we could not do it individually because they would not agree to it, but the commission could do it., I am not against that for Newfoundland. If they want to do it there, that is all right, but why impose it on the Province of Nova Scotia? We think we are in the forefront. We have a splendid market close to us, Boston; and Newfoundland I think is much closer to Europe, and if you want to travel quickly from Vancouver to the eastern part of Canada, you go to Stephenville airport and come back to Halifax.

Last night I heard two or three senators speak and they were against delegated authority and enabling bills that take things out of context and divide this country. They were talking about Ontario not being in this scheme for marketing grain. Do not forget that grain is a big international trading commodity in the markets of the world, but the salt fish business is a business between our country and the United States, between our country and the West Indies, and in years gone by we carried the fish with our own vessels and we brought back salt to Lunenburg and Halifax. In those days Nova Scotia was prosperous.

I think Newfoundland needs more than this bill; they need a merchant marine. A merchant marine is a natural for maritime provinces. If you want to give men employment, give them a job on the sea, but we are told that foreign ships can carry the goods to market and we can get more markets. They say it would cost so much to have a merchant marine. How much does it cost us not to have one? The people of Nova Scotia and Newfoundland are splendid sailors...

The Chairman: Senator, I do not want to limit anything you are saying, but there is nothing about a merchant marine in this bill.

Senator Kinley: No, but it is related.

The Chairman: It is not related to this bill.

Senator Kinley: I am telling you that because it is for better living conditions for the people.

The Chairman: Yes, but it is not something we are going to deal with and write into this bill.

Senator Kinley: All right, but I want to have my remarks on the record.

What I want to say is that if Newfoundland wants to have this bill, that is all right but why impose it on Nova Scotia? There is no politics in this. Every member from Newfoundland voted for it, and they are not Liberals. The only people in Nova Scotia who said much were the Liberals; I did not hear the others say anything.

The Chairman: Well, senator, in connection with the bill, the only way Nova Scotia can come into this is by participation and entering into an agreement with the federal authority? That means the Government of Nova Scotia and the federal Government enter into an agreement.

Senator Kinley: But the point is this, we have dealt with the federal Government for 90 years. The federal Government has handled this for 90 years and now we are making a change, and it is a serious change. I remember we had a fight in the lower house about margarine. You went to the Privy Council and you won your case, and it was a good case, against the butter people, insisting that margarine should have a fair show. All we are asking for is a fair show in this case, and I do not know what they think about it, but I know that I have been in politics for 50 years and I have run in seven elections, and I would regard the fishermen as a strong and able part of our province.

Mind you, people come up here and support this bill from what they call the Fisheries Council of Canada. There is not a fisherman in it; it is a fish packers' association. They say that here is the Fisheries Council in favour of this bill.

Senator Macdonald from Sydney has some amendments that he would like to make to it, I think, and I think Senator Hollett takes a

proper stand. This is a matter of differences of opinion. I want the committee to know the facts and to realize that this is a serious problem for the Province of Nova Scotia for Prince Edward Island and the Gaspé coast, that they are to be subordinated. I do not like it, and I think that if the bill passes you will have another case to go before the Privy Council, Mr. Chairman.

The Chairman: Well, there are no appeals to the Privy Council now.

Senator Kinley: Yes, there are, on certain things, on matters of provincial rights. If it is a matter for the provinces there are, are there not?

The Chairman: No, the Supreme Court of Canada is the last court of appeal.

Senator Kinley: Well, then you could appeal to them. Anyway, I am not going to press the matter. I am only here as a humble advocate as to what the people of my district want, and I am putting this before the committee in good faith.

The Chairman: Are there any other comments?

Senator Hollett: Mr. Chairman, I would like to just get a word or two in edgeways, if I could. This question was raised in the Senate the other day, I think by Senator Lang. He said that he did not think that clause 21(1) was legal. This appears on page 10 of the bill and reads as follows:

> (1) Except in accordance with the terms and conditions set forth in any licence that may be issued by the Corporation in that behalf, no person other than the Corporation or an agent of the Corporation, shall
> (a) export from Canada any cured fish or the by-products of fish curing;
> (b) send, convey or carry from a participating province to another participating province or to any other province, any cured fish...

—and so on. That may be legal, I do not know; but I understood this from a lawyer speaking the other day, and I thought I would raise the question too. I seemed to me awfully funny that if our friend who has just spoken has fish in Halifax and wants to send it to Newfoundland, he is not allowed to do it under the provisions of this particular bill, and vice versa for the rest of the participating provinces.

The Chairman: Senator, if you read and digested the sections of the bill you would understand that before Nova Scotia can be tied into this bill there must be an agreement for participation between the Government of Nova Scotia and the federal authority. Therefose, there is no compulsion at that end; it is a matter of agreement.

Senator Hollett: I know, but it is the prevention of free enterprise; it is a block. I cannot ship my fish from Newfoundland to Nova Scotia, or to New Brunswick or Quebec or anywhere else in Canada, without the consent of this corporation.

The Chairman: If your government makes an agreement with the corporation.

Are there any other questions?

Senator Hollett: It may be all right, but I think...

Senator Carter: I have two questions.

The Chairman: Are you going to put them to Mr. Mackenzie?

Senator Carter: In the past, the Nova Scotia fish operators have developed markets in the Caribbean and other parts of the world and have not been able to fill the orders from their own production. In order to retain their markets, they have had to go into Newfoundland and buy Newfoundland fish. That has been good, because there is an element of competition which kept prices up.

Now, what will happen under this bill? How will these Nova Scotia fishermen be able to meet quotas in their own market if they cannot buy Newfoundland fish?

Mr. Mackenzie: Let us consider the situation if Nova Scotia does not participate.

Senator Carter: If Nova Scotia does not participate?

Mr. Mackenzie: Yes. I think they will participate, of course, but even if they did not, these various buyers in Nova Scotia would still have access to the Newfoundland supply, but they would have to deal with the corporation. But if they were able to offer a better price than a Newfoundland exporter, they will get the supply.

Senator Carter: They could buy from the corporation?

Mr. Mackenzie: They could compete freely for the supply. If, however, Nova Scotia is a participating province, then the corporation has an obligation, as it were, to offer its supply through Nova Scotia shippers as well as Newfoundland shippers. Do I make myself clear?

Senator Carter: Yes.

Mr. Mackenzie: And if Nova Scotia is a participating province it would also have a member of the board of directors for the corporation. In other words, he would have a voice in setting the policy of the corporation. This is the advantage of being a participating province. But from the point of view of traders in Nova Scotia, there is not really very much change.

As I mentioned earlier, at the later stage, if the corporation proves to be a very successful operation, it may very well be that the producers of the Nova Scotia local product pickled and cod fish and scale fish, these producers may also wish to use the corporation as an agent or channel for their export trade, which is mainly with the United States, as Senator Kinley has pointed out.

Senator Kinley: But it is all—

The Chairman: Senator Carter has not completed his questioning.

Senator Kinley: He wanted to ask a question.

The Chairman: No, he has two questions, he has asked only one, so do not rush him, we did not rush you.

Senator Carter: The other question is on quality. The whole success of this enterprise hinges on quality, which means laying down standards. Under what legislation will the standards be established and enforced? I see no power in this bill giving the corporation power to enforce standards.

The Chairman: I think the agreement provides for that standard.

Mr. Mackenzie: The agreement provides for standards, Mr. Chairman, for the responsibility in this case; but obviously the responsibility for setting standards is that of the fish inspection administration.

Senator Carter: I understand it is already defined in legislation somewhere?

Mr. Mackenzie: In regulations, yes, but they are subject to modification. The corporation would have certain powers to enforce standards, which perhaps do not exist now. By being the sole buyer, it would eliminate the scramble for supply, which results sometimes in downgrading of the product from the fishermen. That is one thing. They could also so manipulate the pricing policy for different grades as to encourage the production of better fish and then they may, I hope, be able eventually to bring the production of saltfish together to consolidate this under supervision, which is not the case at present. There are fairly interesting possibilities.

The Chairman: Are there any other questions?

Senator Hollett: What is the need for that particular section? Why shouldn't a person in Newfoundland be allowed to ship fish to Nova Scotia? Why? Is there any such regulation in force with regard to the shipment of wheat or any other product in Canada?

Mr. Mackenzie: Yes, I think so, under the Wheat Board.

The Chairman: Under the Wheat Board Act, yes.

Mr. Mackenzie: This, as a matter of fact, has been copied or modelled on the Wheat Board operation and the freshwater fish operation.

Senator Hollett: Look at what a mess that is in now.

The Chairman: Are there any other questions?

Senator Hollett: I do not know why the chairman wants to throttle my mouth when I am trying to get into a question.

The Chairman: Go ahead, Seantor Isnor.

Senator Kinley: I thought you pointed to me.

Senator Isnor: I would like to inquire as to where this originated, with the Department of Fisheries or another source?

Mr. Mackenzie: There has been a good deal of agitation for something of this nature from the fishermen's organization in Newfoundland. To my knowledge that is the only organization of the industry that has requested legislation of this kind. However, the organization of the trade in Newfoundland and Nova Scotia have agreed with it in principle.

Senator Isnor: What do you mean by "Nova Scotia"? Who agreed?

Mr. Mackenzie: The Nova Scotia Saltfish Exporters Organization. They submitted a brief to a Commons committee in support of this.

Senator Isnor: In regard to Senator Kinley's contention, I think it is sound. I would like to put on record that I am impressed by what Senator Kinley says.

The Chairman: Senator Kinley, you have another question?

Senator Kinley: The absolute right to make the prices lies with this corporation. The price was higher than that for a long time. It is about twice the price to the customer.

Mr. Mackenzie: For some products.

Senator Kinley: I would like to follow that up.

Mr. Mackenzie: The production of Nova Scotia is almost certain to be excluded. I know that.

Senator Kinley: Do you mean like Newfoundland?

Mr. Mackenzie: No. Mr. Chairman, there are extensive consultations with the provinces on this bill. In the case of Nova Scotia, the Government of Nova Scotia and the traders, the organization of the traders interested in this supply from Newfoundland, both these support the bill in principle. There are some reservations about some of the implications or possible implications, naturally; but it has been agreed tentatively—no final agreements can be made until the legislation is passed. It has been agreed tentatively that for the time being, until the producers wish it otherwise, the production of Nova Scotia of pickled cured codfish, boneless codfish and scale fish will be excepted from the control of the corporation.

The Chairman: Will be excluded from control.

Mr. Mackenzie: That is correct.

Senator Kinley: You say that Nova Scotia has agreed with others?

The Chairman: He said the Government of Nova Scotia.

Senator Kinley: I understand he said "Nova Scotia". About this bill. I have not been consulted, and I do not think the members generally were consulted. I never heard about it. It is a surprise.

The Chairman: Are there any other questions? Are you ready for the question? Shall I report the bill without amendment?

Senator Kinley: No.

The Chairman: Then, I shall take a vote by means of a show of hand. Will those members of the committee who support the bill so indicate? Those contrary, if any? By vote of the committee, I shall report the bill without amendment.

Senator Isnor: Mr. Chairman, what was the result of the vote?

The Chairman: It was 7 to 3.

We revert now to Bill C-133. Are there any further questions in respect of this bill, which is a repealing bill?

Senator Kinley: This concerns the bounty?

The Chairman: Yes.

Senator Kinley: I should like to say just a word or two on this bill. I have in my hand a copy of a report of the United States Tariff Commission—it will be remembered that this matter came up under the Treaty of Washington. There was some difficulty about it, and the matter was referred to the Halifax Commission. The Senate of the United States issued a statement in which they said:

> By the operation of the Washington Treaty, in remitting duties (estimated at $350,000 annually), the Halifax Commission awarding an enormous sum against us, the United States is called upon to pay annually a larger sum for the benefit of Canadian fishermen than it ever appropriated as bounties to American fishermen.

Some people claim that there is a right there. I would not go that far, but there is, in my view, a moral obligation. This money was not paid by Canada; it was paid by the American Government. They were against it, but the President of the United States had a high regard for British diplomacy, and, generally, the members of Congress from the New England States—from Vermont and Maine—had more authority in those days than they have now, because the population of the country was larger on the east coast.

The money was paid to the British Government, and the British Government paid $1

million to Newfoundland, and $4.5 million to Canada. Interest was earned on that money at the rate of 5 per cent, and this was paid to our fishermen. Now, after 90 years, we find it is going to be stopped.

In western Canada men were given land and property. I have not heard of that land being taken away from those people, but it is now proposed to take the bounty away from our fishermen.

The bounty does not amount to very much. It is not going to hurt so much if the $10 or $12 a year is taken away from the fishermen. When it was awarded originally it bought two barrels of flour for the winter, and it was an important thing. I feel it is not wise to take that away at the present time, when we are so interested in having good feelings throughout the country. There is a moral obligation involved here. This money belongs to the fishermen of the Maritime provinces.

When I was in the Lower House I talked to Mr. MacNeill from British Cilumbia, the member for Comox-Alberni, who was a brilliant fellow, about the halibut fishery, the salmon fishery, the seals and the Sooke traps for salmon, and he would come back and say to me: "Your are getting the bounty", but I pointed out that there was a reason for it, and the reason was that this was the fishery of the Atlantic coast.

If the Government needs this money and wants to take it back then there is nothing further I can do about it, but I do think that there is a moral obligation here. The Americans said that this money which was for the fishermen was more than any amount they had ever appropriated for their own fishermen. I think the whole amount should have been given to the fishermen, and not just the interest.

The Chairman: Are there any other questions? If not, are you ready for the question? Shall I report the bill?

Hon. Senators: Agreed..

The Chairman: We have one more bill to consider, namely, Bill C-183, to amend the Agricultural Products Co-operative Marketing Act.

Mr. Phillips from the Department of Agriculture is here. Would you give us a short explanation of this bill, Mr. Phillips?

Mr. C. A. Phillips, Director General, Production and Marketing Branch, Department of Agriculture: Yes, Mr. Chairman. The Agricultural Products Co-operative Marketing Act was passed in 1939 for the purpose of encouraging the co-operative marketing of agricultural products. It provided an opportunity for producers to join together to sell their production of any commodity, and for the making of an initial payment. They were able to make the initial payment by entering into an agreement with the Government of Canada, through the Minister of Agriculture, under which the money for the initial payment was guaranteed. The producer organization borrowed from the bank under the guarantee of the Government in respect of repayment and the payment of certain processing and carrying charges.

At the time that this act was passed the Wheat Board Act was in existence, as was another act called the Wheat Co-operative Marketing Act. As such, wheat was excluded from the act, and in recent times the producers of wheat in Ontario felt that they might like to take advantage of this legislation.

The directors of the organization wanted to have th assurance that they could use this act if their producers wanted to use it, but since they were not able to use it they have not had too much discussion with the producers. With the amendment there is no certainty that they will use it. It is up to the producers to decide that they want to use it. There is no compulsion in this bill.

The Chairman: This action is initiated by a declaration of the Canadian Wheat Board under the Canadian Wheat Board Act designating an area in which grain other than wheat may be grown. The producers will now qualify under the provisions of this act; is that right?

Mr. Phillips: Yes, sir, under the current act wheat is excluded, and the purpose of this amendment is to provide that wheat grown in the designated area, which is controlled by the Wheat Board, continues to be exempted but not wheat produced in other areas of Canada.

Senator Desruisseaux: Mr. Chairman, what are the areas that are presently defined?

Mr. Phillips: The designated area under the Canadian Wheat Board Act is Manitoba, Saskatchewan, Alberta, and two areas in British Columbia.

Senator Desruisseaux: Why are not the other provinces also covered? Is there any

raason for that? I am referring to Quebec and the eastern provinces.

Mr. Phillips: Under the act all areas are covered for all agricultural products, except wheat. In respect of wheat there is a distinction that with the amendment wheat in the designated area will still not be covered but will be covered elsewhere, whether it is in Quebec, Ontario, or British Columbia, and milk products are now eligible. Currently there are two agreements under this act, one for apple processing in Quebec and one for white beans in Ontario.

Senator Leonard: May I ask whether there is now in existence a specific area designated by the Canadian Wheat Board?

Mr. Phillips: Yes, there is a specific area.

Senator Leonard: That will be the area to which this act applies?

Mr. Phillips: No, it will not apply to that area.

Senator Leonard: It applies so far as the Wheat Board is concerned, but it does not apply in so far as this act is concerned?

Mr. Phillips: That is right.

Senator Leonard: It requires no further action by the Wheat Board?

Mr. Phillips: That is right.

Senator Aseltine: I asked a few questions about this matter when I spoke in the debate in the house last night. I do not have a note of those questions before me because the Senate *Hansard* of yesterday has not yet been distributed.

Senator Aseltine: I asked some questions with reference to this. I do not have them before me because the Senate *Hansard* has not yet been printed and distributed. I gather from reading what took place in the other place that there was dissension among the primary producers in Ontario, some of them wanting this and others not. Have any of those dissenting producers asked to be heard before this committee?

The Chairman: No requests.

Senator Aseltine: Have they had an opportunity to do so? Perhaps you could tell us something about this dissension, if there is any dissension?

Mr. Phillips: There certainly was some indication in the discussion in the house that there might be dissension, but we are not aware of it. Indeed, the dissension, if any, the discussion, if we put it that way, will be among the wheat producers. There is nothing in the bill that will require the wheat producers to use this act. It will only be used if they decide among themselves that they want to use it, come to the minister saying "Would you allow us to use it" and enter into a contract with us. The decision remains with the producers. As I tried to explain at the outset, the directors of the Ontario Wheat Producers Marketing Board have an idea that the producers might like to use this, but they could not suggest it to them because there was no authority in the act to use it. With the authority to use it if they wish they have two ways to proceed: under the Agricultural Products Co-operative Marketing Act, or the way in which we have been operating since 1958, which is slightly different. There will be two clear choices for the producers to vote on and it is up to them to decide in which way they will proceed.

Senator Aseltine: I take it there is no compulsion whatsoever?

Mr. Phillips: There is no compulsion.

Senator Aseltine: If an application made to the Government to guarantee bank loans when these initial payments can be made is not satisfactory that is the end of it and they do not need to renew the agreement. For what period would that agreement be? Is it for one crop?

Mr. Phillips: It is for one crop, based on the act. It has to be an annual review and the level is based on the prices in the three preceding years. Therefore the contracts have to be renewed annually.

Senator Desruisseaux: Are these options to be exercised by individual farmers or by groups?

Mr. Phillips: They are to be exercised by the group. It refers to a co-operative association.

Senator Desruisseaux: Have you pursued the possibility of some of them being against it?

Mr. Phillips: No, it is not designed in that sense. There is that type of marketing legislation under the provincial legislation where if the majority agree that they want it the others must follow. This act is not designed in that way. It provides that if a group wishes to

market they come to the minister and ask if an agreement can be entered. The act points out that the minister has to take into account the number who wish to do so, in order to determine if there would be any point in proceeding.

Senator Aseltine: Where is this wheat sold? Is it exported, or used for making flour for sale in Ontario?

Mr. Phillips: The wheat in question in Ontario is a soft wheat, which is used for pastry. The bulk of it is sold for domestic use but, like all agricultural products, production varies with the weather. In some years they have an excess, which has to be exported. In other years a minimum will be exported.

Senator Aseltine: Can the primary producer sell outside the board?

Mr. Phillips: The Ontario wheat is sold under Ontario legislation, which requires that it all be sold under the legislation through the board, but they use agents for the purpose.

Senator Aseltine: Can a primary producer sell to his neighbour?

Mr. Phillips: Yes, without coming under the act.

Senator Aseltine: Can he sell in Quebec?

Mr. Phillips: No. He can sell to Quebec through an agent, but at the prices that have been negotiated under the Ontario legislation.

Senator Aseltine: About how many primary producers in Ontario grow this kind of wheat?

Mr. Phillips: I believe that approximately 26,000 produce Ontario wheat.

Senator Aseltine: Is it mostly winter wheat?

Mr. Phillips: It is all winter wheat.

Senator Aseltine: And it is softer wheat than our No. 1 northern grain?

Mr. Phillips: Yes.

Senator Aseltine: In the western provinces?

Mr. Phillips: When there is a shortage of Ontario wheat the comparative crop in western Canada is Alberta red winter.

Senator Aseltine: How are the members of this board elected? They are not appointed by anyone. Are they elected or appointed?

Mr. Phillips: The members of the Ontario Wheat Producers Marketing Board are elected under Ontario legislation.

Senator Aseltine: Is it similar to the Saskatchewan Wheat Pool, who have districts and members elected from each district?

Mr. Phillips: I believe it is essentially the same.

Senator Desruisseaux: In view of the fact that they have to sell through the board, what happens in the event of over-production?

Mr. Phillips: This same interest has been shown in the possibility of using this legislation under the current arrangement in Ontario. They negotiate price with the millers. Once that is established all the wheat must sell at that price or higher. In order for it to operate, the elevator companies have to pay that price and they would not buy wheat unless the board undertook to take it off their hands if it could not be sold in Canada. Once it is delivered to the board they have to find a market. They impose a levy system and take 16 or 17 cents off the selling price, which goes into a pool and is used for selling the surplus at a lower price on a two price system. If they do not expend all the funds, they return the difference to the producers.

Senator Aseltine: What storage facilities does the board have to take care of wheat and place it where it can be delivered when there is a sale in prospect? Do they store it on the farm?

The Chairman: Do you mean the Ontario board?

Senator Aseltine: Yes.

Mr. Phillips: The Ontario board do not have elevator space of their own. They use the country elevators in Ontario and some of the eastern elevators. They have had an arrangement in the past with the National Harbours Board in Montreal. When there is a prospect for overseas sales, the wheat is assembled at Montreal to make up a portion of a boat load.

The Chairman: Shall I report the bill without amendment?

Hon. Senators: Agreed.

The committee proceeded to the next order of business.

Queen's Printer for Canada, Ottawa, 1970

Second Session—Twenty-eighth Parliament
1969-70

THE SENATE OF CANADA

PROCEEDINGS

OF THE

STANDING SENATE COMMITTEE

ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 13

WEDNESDAY, MARCH 18th, 1970

Seventh Proceedings on the Government White Paper,

entitled:

"PROPOSALS FOR TAX REFORM"

WITNESSES:

Anglo American Corporation of Canada Limited: David Taylor, Q.C., Director and Counsel; C. J. Risby, Vice-President and Treasurer. *Council of the Forest Industries of British Columbia:* Gordon L. Draeseke, President and Chief Executive Officer.

APPENDICES:

A.—Brief from Anglo American Corporation of Canada.
B.—Analysis of Appendix "A" by Senior Advisor.
C.—Brief from the Council of the Forest Industries of B.C.
D.—Analysis of Appendix "C" by Senior Advisor.
E.—Addenda to Special Study No. 5.

21640—1

THE STANDING SENATE COMMITTEE ON

BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aseltine
Beaubien
Benidickson
Blois
Burchill
Carter
Choquette
Connolly (*Ottawa West*)
Cook
Croll
Desruisseaux
Everett
Gélinas
Giguère
Grosart
Haig
Hayden
Hays
Hollett
Isnor
Kinley
Lang
Leonard
Macnaughton
Molson
Phillips (*Rigaud*)
Walker
Welch
White
Willis—(30)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

"With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intituled: "Proposals for Tax Reform", prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

"With leave of the Senate,

The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Hayden:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative."

ROBERT FORTIER,
Clerk of the Senate.

21640—1½

MINUTES OF PROCEEDINGS

WEDNESDAY, March 18th, 1970.
(17)

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 10:15 a.m. to further consider:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Hayden (*Chairman*), Aseltine, Beaubien, Blois, Carter, Cook, Desruisseaux, Flynn, Everett, Gelinas, Haig, Hollett, Isnor, Kinley, Leonard, Macnaughton, Martin, Phillips (*Rigaud*) and Welch—(19).

Present, but not of the Committee: The Honourable Senators Laird, McDonald, Smith and Sullivan—(4).

In attendance: Arthur W. Gilmour, Senior Advisor; Alan J. Irving, Legal Advisor and Roland B. Breton, Executive-Secretary.

The following witnesses were heard:

Anglo American Corporation of Canada Limited:

David Taylor, Q.C., Director and Counsel.

C. J. Risby, Vice-President and Treasurer.

Council of the Forest Industries of British Columbia:

Gordon L. Draeseke, President and Chief Executive Officer.

Mr. Gilmour presented to the Committee an *addenda* to Special Study No. 5.

Ordered:—That the documents submitted at the meeting today be printed as appendices to these proceedings, as follows:

A—Brief from Anglo American Corporation of Canada.

B—Analysis of Appendix "A" by Senior Advisor.

C—Brief from the Council of the Forest Industries of B.C.

D—Analysis of Appendix "C" by Senior Advisor.

E—Addenda to Special Study No. 5.

At 12:50 p.m. the Committee adjourned to the call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

Ottawa, Wednesday, March 18, 1970

The Standing Senate Committee on Banking, Trade and Commerce, met this day at 10.15 a.m. to give further consideration to the White Paper entitled "Proposals for Tax Reform".

Senator Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: The first submission is by the Anglo American Corporation of Canada Limited, and we have Mr. David Taylor, Q.C., Director and Counsel, and Mr. C. J. Risby, the Vice-President and Treasurer. These are two good people to have here.

Mr. David Taylor, Q.C., Director and Counsel, Anglo American Corporation of Canada Limited: Mr. Chairman, honourable senators, I will try not to be too long.

The Chairman: Well, let us see how it develops.

Mr. Taylor: May I first say how much the company and the principal shareholders for whom we are speaking this morning appreciate the opportunity of being able to appear before this committee and supplement the brief that has been delivered to you.

A summary of the position as far as we are concerned would be that the interests of Anglo American Corporation of Canada Limited are those of the investment arm in Canada of a large international mining and finance group with many opportunities for mineral investment abroad, but which has invested substantially in Canada on a basis reflecting current after-tax rates of return to mining companies. We are greatly concerned about the impact of the White Paper proposals on taxation of resource industries.

Largely financed by non-resident investors, we are equally concerned about the impact of the White Paper on non-resident investors, and particularly on non-resident investors in the extractive industries. Within the group we believe that the adverse treatment of non-resident investors in the White Paper, if it is implemented without substantial modification, will be to concentrate the group's attention on investment opportunities abroad, to reduce the continued expansion within Canada of our companies, and to defer indefinitely certainly large scale Canadian investments currently under consideration, to divert elsewhere within the group foreign investment opportunities now available for our companies, and to force the repatriation of substantial amounts of capital by associated Canadian companies.

In domestic terms, we believe that there should continue to be a tax free flow of dividends as between Canadian companies. The artificial distinction between widely-held and closely-held companies should be abolished. Incentives for small incorporated businesses, we believe, can be accomplished by other means. The two and a half year limitation on corporate distribution for creditable tax purposes is too short a period. The present proposals will force a major restructuring of our Canadian operations for tax and not for business reasons.

The Chairman: Are you going to develop that and explain it?

Mr. Taylor: Yes, sir. I was attempting to summarize our entire brief in an initial statement.

The Chairman: That is all right. I just wanted to be sure you were going to elaborate on it.

Mr. Taylor: Equally, we are opposing the differential treatment of capital gains on shares of widely-held and closely-held corporations. We think both should be treated alike. The proposed tax on unrealized gains should not be implemented. Consideration should be given to tax and capital gains at different rates, with long term gains being exempt and separate rates for medium term gains, and gains within a relatively short period of time being taxed as ordinary income. However, the rate on medium term

gains should be less than the rates on ordinary income to encourage capital formation.

The proposal to tax non-residents on gains realized and unrealized in Canada has no counterpart in any other major tax system. In the interests of continued non-resident investment in Canada, quite apart from the substantial difficulties in implementing the necessary tax treaty changes, such a tax should not form a part of a new system.

To be truly effective, we believe that the incentives offered the extractive industries should accrue ultimately as a net saving to investors. Thus provincial mining taxes, earned depletion and accelerated depletion taken by a company in the year should be included as part of the company's creditable tax for dividend purposes. All capital costs for new and existing mining should be available for accelerated appreciation and earned depletion. The rate at which depletion is earned and the rate at which it can be deducted should be altered. The proposed incentives will not be as attractive to non-resident investment capital. The international mobility of executive skills is important, and the proposed treatment of Canadians posted abroad for temporary periods and non-residents posted to Canada temporarily is inequitable.

Finally, we are concerned that business reorganization should be facilitated on liberal terms under the proposed system, and that formal advance tax rulings should be available as part of such a system.

Mr. Chairman, that concludes our summary on the position we have taken in the brief.

The Chairman: Now would you tell us what is behind each one of those statements. What supporting material have you? You must give us an outline of the nature and scope of the operations of this company and the make-up.

Mr. Taylor: The first section in our brief that has been delivered to the committee indicates that the company, which for convenience we call Amcan throughout, is part of a substantial mining and finance group with assets worth $3,000 million at the end of 1968.

Senator Phillips (Rigaud): May I interrupt just for one moment for the guidance of the witness. I may say at the outset that I regard this brief as very impressive, but in the analysis of the points you are about to make there is an impression in some circles—I will not say where—that the possible export of capital from Canada resulting from White Paper suggestions is more in the nature of threat rather than being something very serious expressed by major industrial and major business units in this country, of which you are one. There is a further feeling in some circles that the suggestion that there is a retardation of capital coming into the country for normal expansion does not conform to the facts. In the presentation of the points that you are raising, I think it would be very helpful to the senators if you would be good enough to tie in realistically your views in respect of these matters.

Mr. Taylor: Thank you, Senator Phillips. In the brief, which I will come to in a minute, we have a very specific example of the effect of the White Paper proposals, which will force an export of a substantial sum of capital by an associated company of ours, a company called Interlink Investments.

Senator Phillips (Rigaud): I do not want to interfere with your presentation, and please go back to your original concept, but I think my colleagues here would like more emphasis on these two aspects, the flow of capital out and the retardation of capital in.

Mr. Taylor: The background portion of the brief indicates the nature of the group's opportunities to invest abroad, the fact that it is actively engaged in mineral resource investment on the major continents of the world. It also indicates the type and nature of the assets held currently in Canada by Amcan. You will find on page 2 of the brief a breakdown by values of the principal types of investments held by this company as at the end of last year. I draw your attention on that page to our associate company and investments, which has assets, including its investments in Amcan in excess of $28 million.

The Chairman: Is Interlink a subsidiary of Amcan?

Mr. C. J. Risby, Vice-president and Treasurer, Anglo American Corporation of Canada Limited: It is a subsidiary of a London company.

Mr. Taylor: It is a shareholder of Amcan.

The Chairman: A substantial shareholder?

Mr. Taylor: Yes.

Senator Leonard: Aren't you also connected with the Hudson Bay Mining and Smelting Company Limited?

Mr. Taylor: Yes, that is shown on page 2 of the brief.

Senator Leonard: I was looking at the appendix.

Mr. Taylor: The diagrammatic chart indicates only the wholly owned subsidiaries. It does not show the investments held by subsidiaries. You can see that we have an investment value at the end of the year with Hudson Bay Mining and Smelting Limited in excess of $68 million.

Senator Leonard: What is the percentage?

Mr. Taylor: Twenty-eight per cent. We also wish to draw the committee's attention to an investment which we think is important, although in dollar terms it does not appear to be as significant as others. This is in the Baffinland project. Here is an almost unequalled opportunity for the development of the Arctic in the form of a huge deposit of iron ore superior in grade to that found anywhere in nature. The cost to develop this will exceed $100 million, and we are concerned that under the White Paper proposals such development will not proceed.

Senator Gelinas: Does that figure of $100 million include the pelletizing plant.

Mr. Taylor: No, sir, that does not include the cost of the ships, which would be especially constructed to carry away the iron from the St. Mary's River port. It does not include the cost of a treatment plant, but simply the facilities at the mine site and access to the harbour, however, nothing more.

Senator Beaubien: Not the harbour installation?

Mr. Taylor: Yes, it does include a figure for the harbour installation.

Senator Laird: Mr. Chairman, I might ask the witness if he were to abandon the Baffin project, to what country would he likely divert funds that would otherwise be used for that project?

Mr. Taylor: Sir, statistics in the mining industry are not always meaningful for comparative purposes, but I have heard from a number of quarters that you can spend $10 million to find a mine in Australia but $30 million to find one in Canada. Even if the tax treatment were to be the same, which is not the case, you could expect that there would be a substantial intensification of investment in Australia.

Senator Laird: You mentioned Australia. Quite frankly, would there be other areas in the world in which you would be equally interested?

Mr. Taylor: Yes, sir, I think it is fair to say that the group is currently quite interested in Malaysia.

Mr. Risby: Mexico, South America and to a certain extent any mineral-rich area of the world is a matter of interest to a group of this size.

Senator Laird: Would your principal interest in that country be because of a better tax deal?

Mr. Risby: That is only one of the factors, sir.

Senator Laird: It is one?

Mr. Risby: A very important one. Our investments in Canada, as we have said, were based on the after-tax cash flow available to us as investors, as well as the stable political climate and the mineral resources that are known to be here.

Senator Laird: Thank you.

Senator Desruisseaux: Supposing that the tax reform goes through as it is proposed presently, would it stop your company from developing that mine up north?

Mr. Taylor: We believe it would, sir.

Mr. Risby: It would require complete new feasibility studies.

Senator Everett: I understand the point you make is contained in appendix B, that if you were to pay out your earnings directly to a non-resident shareholder the tax is less than if you keep the money employed in corporations doing business in Canada. Therefore, it is to the advantage of a company to pay out and remove the money from Canada. What I would be interested in knowing is what is the tax effect in the non-resident country? Let us take, for example, the United Kingdom or South Africa. What happens under your proposals if $85, under proposal 7, which is a direct pay-out from H.B.M. is to a non-resident shareholder residing in England? What is the effect on him as compared to item No. 6 which shows the same effect of a pay-out through Anmercosa to Amcan with Anmercosa electing the partnership option?

Mr. Risby: First, if I could make a contrast, taking the United Kingdom with South Africa for a moment, in the case of a direct payment to an English company they would be able to gross up the amount received by the underlying rate of tax paid which had been deducted and the withholding element. In the case of South Africa, the $85 is received, assuming a 15 per cent withholding and no recovery of that withholding tax.

Senator Everett: Let us take South Africa. The $85 is taken as income in South Africa and the taxes are paid on that with no credit against the tax for the withholding tax?

Mr. Risby: No further tax is paid in South Africa.

Senator Everett: And no credit?

Mr. Risby: Correct.

Senator Beaubien: It is tax-free?

Mr. Risby: The amount received from Canada is tax-free.

The Chairman: What about Australia, as offering a better climate. Mr. Taylor made some suggestions in that regard.

Mr. Taylor: I do not have figures, Mr. Chairman, showing the effect of receipt in South Africa of an Australian dividend. We understand it would be the same as for Canada.

The Chairman: Anyway, the least expensive way of dealing with the moneys that you have in Canada would be to pay them out?

Mr. Taylor: That is right for the closely held corporation, which is what Interlink is. To continue in existence as our shareholder and take its proportionate interest in the dividends flowing through Amcan from Hudson Bay and Interlink to the English parent is very much more expensive than currently under the White Paper proposals. Appendix B, table 1, shows the drastic reduction that can happen from the original $100 dividend paid by Hudson Bay. I think it is fair to say that it is the considered opinion of the English company, Interlink, that if the White Paper proposals are implemented they would be obliged to liquidate.

Senator Everett: Let us follow that through for a moment. Let us take the United Kingdom Interlink's position. What happens under proposal 7, if we did liquidate all the conduits to Interlink? While the 15 per cent withholding tax is paid—what happens to the holdings in Interlink's hands in the U.K.?

Mr. Risby: The London parent company of Interlink is able to gross up the sum received by the total tax in the hands of Interlink. It grosses up the amount of tax which has been paid in Canada. That grossed up sum is then subject to full taxation.

Senator Everett: What is the difference in tax? Let us follow that through. What is the difference in tax in the U.K., between 6 and 7? If you get it grossed up, how do you get the effect of the taxes?

Mr. Taylor: I think the answer is that you do not get them all the way down.

Senator Everett: It seems to me that either you gross up or you do not gross up.

Mr. Taylor: I understand there are limitations as to the number of tiers through which you can do it.

Senator Everett: I think we should know what those limitations are, because the suggestion you are making is that if you interpose a closely held corporation between a widely held corporation and its U.K. holding, you are going to end up paying a greater tax in the amount of money that eventually is received by the U.K. owner. If there is a grossing up of all the taxes down the way, then it is not going to matter whether you pay it direct and just have the 15 per cent withholding, or whether you pay it through the chain. In other words, you are arguing for a fall on that ground. So I think it is essential that we have more detail, to buttress that argument. I am not asking for it now, but perhaps we could get it later.

The Chairman: It may be that Mr. Gilmour could give us a brief explanation to clarify this point, and then you can continue.

Senator Everett: I think I have asked all my questions.

The Chairman: Mr. Gilmour may provoke another question from you.

Mr. Arthur W. Gilmour, Senior Adviser to Committee: I must confess that my knowledge of British income tax is presently very slight, although it is growing awfully rapidly as the result of certain questions which Senator Phillips (Rigaud) has asked of me, but essentially the British system of levy is similar to

our own present system, that is, a dividend that flows to a U.K. company is subjected to a U.K. tax of 45 per cent, which is their flat rate at the moment.

Now, they do give relief for the Canadian effective rate of tax that is paid. In most instances, the Canadian rate of tax is an annual rate of about 52 per cent and then the withholding tax of probably 15 per cent of the net remaining 48 per cent. So the effective Canadian rate is about 61 per cent as compared to the British rate of 45 per cent.

Senator Everett: Where is that? They receive credit for that?

Mr. Gilmour: Up to 45 per cent. So the British company is out of pocket and cannot in any way recover the excess 16 per cent which you pay for the privilege of owning the investments in a Canadian subsidiary company.

Senator Beaubien: The money that flows to the British parent is more highly taxed than it would be in England. It does not incur any more tax?

Mr. Gilmour: It does not incur any more tax in Great Britain, until in due course its parent company in Great Britain distributes its income by way of dividend to individuals who live in the United Kingdom. They are in a manner similar to our own system. These individuals pay income tax and surtax upon the dividend they receive and they no longer get any tax credit for the tax that was paid by the corporation.

Senator Beaubien: Yes.

Mr. Gilmour: As you know, the British system was changed in 1966.

Senator Beaubien: But, Mr. Gilmour, as long as the company holds it, there is no more tax? If it is paid out to the shareholders, yes. But if the company holds the money it gets from Canada, there is no more tax?

Mr. Gilmour: That is right to some extent, senator. There are some provisions in the British Income Tax Act that enable the income tax collector to say "you are improperly accumulating amounts in excess of what you need". It was equivalent to that horrible section we had once. We threw it out.

Senator Leonard: Your explanation, Mr. Gilmour, in reply to the question as to the difference between items 6 and 7, the final figures at the bottom, is that the $75 under No. 6, compared to $85 under No. 7, truly represents the difference between the two methods, taking into account the U.K. taxation.

Mr. Gilmour: I believe, Senator Leonard, these are the amounts, the bottom amounts of No. 6 and 7, represents the dollar amount that would flow to the United Kingdom, and ignores what the tax position in the U.K. is.

Senator Leonard: Yes, but I think Senator Everett is asking his question, as to what is the effect of the U.K. taxation system, and your explanation, as I understand it, is that the U.K. tax would not affect the relative difference between those two methods.

The Chairman: You mean, it would not change those figures?

Senator Leonard: It would not change them—the difference between the two figures, at any rate.

Mr. Gilmour: Those figures are computed on the assumption that the White Paper is adopted.

Senator Leonard: Right, and one involves a change in the structure, so as to get a direct payment out to the U.K., and the other involves the credit tax system.

Mr. Gilmour: Yes, and because the British rate of tax, the rate of corporation tax is limited to 45 per cent, therefore there is no additional impact in the United Kingdom.

Senator Leonard: I think that answers your question, Senator Everett, as to what you had in mind.

Senator Everett: It is the answer as to the method that is employed. I would be interested in seeing the actual figures that the U.K. holding company and the shareholders of the U.K. holding company are going to be faced with, as far as their tax is concerned—taking that into account...

The Chairman: Is that important, senator?

Senator Phillips (Rigaud): I was going to put that question, is it important and relevant to the problems we are facing in Canada.

The Chairman: I was just wondering, are we not taking it too far?

Senator Everett: I do not want to labour the point.

The Chairman: I do not want to shut out discussion.

Senator Everett: It seems to me that the point or the angle I am going on is this. It is worth their while destroying the corporate structure that exists, of a widely held corporation, and perhaps a series of closely held corporations, ending up with a U.K. owner, and having Hudson's Bay Mining owned by the U.K. owner, so that there is just a straight pay out of all dividends to the U.K. owner, so that the only tax that is imposed by Canada is the 15 per cent withholding tax, after the corporations taxes are delt with.

The Chairman: I think the suggestion inherent in what they have said is that the increment arising out of the operations in Canada, if the White Paper goes through, would be taken out, would not be spent in Canada, and would not be available to be spent in Canada.

Senator Everett: Precisely what I am saying. They are saying that they would destroy the structure in between and pay the dividends straight out.

The Chairman: Yes.

Senator Everett: They would have the opportunity of putting that back into Canada, if they desired, and spending the money there. They are saying once it is out it may not come back. It might go somewhere else.

The Chairman: They are saying that the climate of the White Paper is not conducive to reinvesting the money in Canada.

Senator Everett: I am wondering whether they are saying that, really. Perhaps we should not put words in their mouths. I suggest what they are saying is that the money can go out and it does not have to come back.

Mr. Taylor: We are saying it is not conducive and that there appears, on the advice we have had from England, senator, an absolute net in the tax cost of paying dividends through Interlink. I don't want our position to be misunderstood. We are not talking about Anglo American Corporation of Canada being dissolved. Column 7 on this table just illustrates the fact that it is still better to have direct investment in Hudson Bay Mining by some individual corporation in the U.K. We are not suggesting that that would flow here. We are simply suggesting that Interlink Investments, which is a company holding shares of Anglo American would disappear. It has accumulated assets of $40 million. It has been used to stop the dividends, as you can see by the references on page 5 to the amount of money actually paid out. It has been used to stop the flow of dividends coming from its investments in Canada, and they have been re-employed in Canada and this is a loss to the Canadian economy that will accrue.

Senator Everett: I think I understand that.

Mr. Taylor: There is also, apart from the dividend problem, the fact that Interlink as a closely-held corporation faces revaluation every five years, if other proposals are implemented, of its holdings in Anglo American, which as we see it would have to become a widely-held corporation. This tax on unrealized gain is most unpalatable.

Senator Everett: That is another matter.

Mr. Taylor: It is another matter, but it is another reason why we would be obliged, in our opinion, to liquidate Interlink.

Senator Everett: It is important to know whether you stop at the point where the dividend is paid out. It is also important to know what the effect is of tax credits at the other end.

Senator Leonard: Mr. Gilmour has told us that, I think.

Senator Phillips (Rigaud): May I ask the witness to turn to page 5 and be good enough to read into the record the last sentence of the paragraph with respect to liquidation of Interlink?

Mr. Taylor: Yes.

> "We believe the White Paper proposals will force the liquidation of Interlink which presently has net assets worth $40.2 million with the consequent loss to the Canadian economy of the retention of capital and earnings."

Senator Phillips (Rigaud): Thank you.

The Chairman: That is the reason why we have been discussing this.

Mr. Taylor: Yes, that is the reason why we have been discussing this, sir.

If there are no more questions on that background, perhaps we could proceed to the next section of our brief, which is a series of general comments.

Senator Cook: Mr. Chairman, would the witness know whether there are other compa-

nies in the same situation as Interlink? Perhaps that is not an appropriate question to put to the witness.

Mr. Taylor: As it happens, I do know that there are other companies in the same situation, sir. There are companies not unlike the group for whom I am speaking this morning; but I could not be any more explicit than that.

Senator Cook: Would they involve substantial amounts of capital?

Mr. Taylor: Yes, sir, they do; in my eyes, at least.

Senator Phillips (Rigaud): In your opinion, would the amounts of money involved in these other companies be equal to or in excess of the figure you have just mentioned with respect to Interlink?

Mr. Taylor: Altogether they would be in excess.

Senator Phillips (Rigaud): To your knowledge, altogether they would be in excess of the Interlink figure which you have just mentioned?

Mr. Taylor: Yes, sir.

Senator Phillips (Rigaud): Thank you.

Senator Macnaughton: Mr. Chairman, paragraph 9 on page 4 of the brief reads as follows:

> Because of the size and diversity of Amcan's investment in the extractive industries in Canada we are gravely concerned about the impact of the White Paper proposals on the taxation of resources industries.

I wish to call attention to that statement, which I understand means that you have been largely financed by non-residents.

The Chairman: The significant part there, senator, about which I thought you were going to ask a question, is that they add at the end of that paragraph the words "and particularly on the non-resident investor in the extractive industries". What is the extra weight there that you are referring to?

Mr. Taylor: Our project in Baffinland may be an excellent example of that. It is going to require in excess of $100 million. Those funds are not available within our group, as you can see by looking at the assets we have listed. The funds must be supplied from other sources. But the effect of the White Paper proposals on the extractive industries is to destroy, in terms of the shareholders, the incentives that are offered.

The Chairman: You are referring now to the tax holiday and the depletion allowance.

Mr. Taylor: The effect of integration is to remove any of these incentives, Mr. Chairman.

The Chairman: But we were told by Noranda that the pattern now of raising money for the extractive industry is a well-settled pattern and that that pattern is based on the existence of a tax holiday and the existence of the depletion allowance. Now, is that what you are thinking in terms of?

Mr. Taylor: We do think in terms of that, in one sense. We are dissatisfied, if I can put it that way, with the suggestion that it will be possible to continue to finance mines as they have been in the past by making use of the accelerated capital cost allowances available to new mines only. That is not what we think, but we do deal with that in certain detail later on in the brief.

The Chairman: But there is another problem, however, isn't there, Mr. Taylor, to the extent that you are allowed to write off capital cost allowances and to write off your exploration and development expenses. Before arriving at your taxable income you come to a much lower figure of tax credit that is available to the shareholder, if you are going to pay a dividend.

Mr. Taylor: That is correct, sir, so that not only are you making it more difficult for the actual mining company itself to repay its financing in short order—and the riskier the prospect the shorter the period the financiers would like to have, but you are also saying to the shareholders that it does not really matter what incentives are offered to the mining company, because the instant it pays a dividend those incentives will be taken away by reason of the proposed integration.

Senator Macnaughton: You do give concrete examples in paragraph 8, just before the paragraph I cited.

Mr. Taylor: Those are examples of our current investments. We do give examples later on of the effect, and I would prefer to deal with that later on, if I may, sir.

The Chairman: All right. You may go ahead, Mr. Taylor.

Mr. Taylor: Our general comments, sir, reflect only our anxiety about the adoption of a system which is not familiar among the various nations, and the fact that this system, apart from the specific adverse effects with which we will be dealing, is going to force a restructuring of the entire complex that has been built up in accordance with what was considered normal business practices in Canada. Simply to avoid certain of these adverse consequences, it has been the group's policy, as the brief points out, to invite participation of the public in its investment ventures in various countries. This is the case for Canada, but this is hardly an appropriate time, quite apart from the question of tax, to consider launching a company of this sort on the public. The stock market situation is not at all favourable.

The Chairman: Going back to your Baffinland situation which intrigues me, and you talk about needing $100 million and the problem is in what fashion you would raise that. Some of it would be debt and some of it might be share capital. Now there are two problems you would have to look at, and the first one is whether you figure you could raise that kind of money in the money market in Canada or would you have to go outside Canada.

Mr. Taylor: I think it would be difficult to raise the amount of debt that you would hope to raise for a project of that size within Canada.

The Chairman: Now, if we assume that you have to go outside Canada and the proposals in the White Paper are enforced, what problems does that present?

Mr. Taylor: I think we are presenting to external lenders, if you like, a much more restricted flow available for debt repayment and to secure the interest charges on this debt, so that the safety factor has in the eyes of the lender been cut down. This means that he will either hesitate about such an investment or demand terms more favourable to him and less favourable to the company and to its shareholders.

The Chairman: And to the extent that you are trying to raise it by share capital, you would have to do the same thing because the shareholder would not have a depletion allowance.

Mr. Taylor: If there is no depletion allowance, the effect of the incentives amount to a certain affirmative tax here upon dividends being paid, and in addition the consequences of the diminished cash flow available for debt repayment means that his equity portion is less favourable in that sense as well. So he has two adverse impacts hitting him.

Senator Carter: My question is probably the same as you were developing because I did not hear too clearly what was being said. On page 5 at paragraph 12 you say you talk about the possibility of the proposals in the White Paper coming into effect and that it would not pay you to do this. I mean it would be of no value to you to do this.

Mr. Taylor: No, senator. Our posture under the White Paper proposals is this, that our substantial investments in Anglo American Corporation in Canada are in widely held companies and the best posture we can find to minimize the tax costs and the consequence is to make Anglo American itself a widely held corporation. That means that for what we consider to be our official reasons of tax we are being forced to consider making this a public company at what would otherwise probably be considered an unfavourable time, an unpropitious time to approach the public and invite them to invest. After all our major investments are in the resource industries and they are the industries that are being hit hardest of all. We will not get a favourable reception from the public on that score.

Senator Carter: I am thinking if you were approaching it from the standpoint of the effect on your company.

Mr. Taylor: No, as we see it, we depend on a substantial dividend cash flow from Hudson Bay Mining. The only way to eliminate additional tax on that is to make Anglo American Corporation of Canada Limited a widely held company and hope to get certain relief in respect of creditable tax if that is still to apply.

Senator Laird: Do you know of any country in the world that taxes unrealized capital gains?

Mr. Taylor: No, not in the sense being suggested here. We have learned of none. I think it could be said that estate taxes, if you like, constitute a tax on unrealized gains at the time of death. That is certainly a common situation.

The Chairman: The moment you convert AMCAN into a widely held company, you are

exposing the shareholders to the five-year revaluation.

Mr. Taylor: Yes, sir. We have no perfect solution here under these White Paper proposals and our company is adversely affected no matter what we do. If we become a widely held corporation to avoid additional tax on the dividends flowing to us and to avoid the consequences of having to revalue every five years our investments in Hudson Bay Mining, then we just pass that problem on to our Canadian shareholders. We may not pass them on to all our non-resident shareholders, but we are talking in terms of inviting Canadian public participation.

Senator Cook: On the point of unrealized gains, which I think is not altogether the point, don't they in England cause estates to be revalued every 15 years and don't they have to pay tax on them?

Mr. Taylor: I don't know about that.

Senator Phillips (Rigaud): I think it relates itself to trusts of a particular kind.

Senator Everett: On page 11 of your brief you deal with the question of integration and you say that there is a largely artificial distinction in the corporate structures. I assume you are referring to distinctions between widely held and closely held corporations.

Mr. Taylor: Yes, sir.

Senator Everett: How do you say that that is a largely artificial distinction?

Mr. Taylor: I should say it is entirely artificial because I really think that is what it is. As I read the White Paper it appeared to me that the authors started with the laudable desire to equate a private businessman who has not bothered to form a corporation to carry on his business and the same private businessman or a person in similar circumstances who has spent the money to incorporate his business, and I would think the tax impact on those two should be the same. I suggest that effect can be accomplished in other ways, for example by use of the partnership election that the White Paper itself suggests. By why should Mr. Eaton which is really a closely held corporation and Mr. Simpson be taxed on a different basis because one happens to be closely held and the other happens to be widely held? I think when you talk about substantial taxpayers in this position, the distinction is completely artificial.

Senator Everett: It seems to me that you have to give that argument two considerations. First, you take the particular case of Mr. Eaton versus Simpson's whereas I would tend to deal more with the general problem. Secondly you must consider that Mr. Simpson has a market for his shares which Mr. Eaton does not have, and, therefore, it seems to me that the distinction is not so much artificial when you talk about the matter of a closely held corporation shareholder getting his money out and into his hands so that he can deal with that money, because there is no other way of realizing on his investment other than by selling the whole corporation. If he has a minority interest, he is in a worse position because he has nothing to sell at all, but the shareholder of a widely held corporation does have a market. So therefore it is not really an artificial distinction.

The Chairman: What you are overlooking is that a closely held corporation has had the choice and it has chosen to go that road.

Senator Everett: But it seems to me that the distinction is very real because of the difference in the problems that face the shareholders of a widely held corporation and those that face the shareholders of a closely held corporation.

Senator Phillips (Rigaud): Mr. Chairman, I think it is the other way around. The shareholder in a privately held corporation can capitalize his surplus at a very flat minimum rate, in the neighbourhood of 16 per cent, and get a senior security which upon redemption is not taxable, whether preferred stock or funded debt; whereas the shareholder of a publicly-listed security is simply not in that position because he has nothing to say about it, unless the board of directors says that it should be done, in the first place, and, secondly, the majority of shareholders are required by by-laws to agree thereto.

The Chairman: That is right.

Senator Phillips (Rigaud): I strongly support the statement of the witness that the distinction between private- and publicly-held companies is not simply artificial but I think it is ridiculously artificial.

The Chairman: Senator Macnaughton? We will come back to you in a minute, Senator Everett.

Senator Macnaughton: At page 9, paragraph 6, you say:

> The major areas of our concern, which are elaborated upon hereafter, are ...(a), (b), (c).

Might I suggest that we proceed and take them up one by one?

The Chairman: Yes, but we will get Senator Everett's question in ahead of that.

Senator Everett: Just going on with this point, I gather from the way your brief reads that the concern you feel in the widely-held corporation is to hold the earnings in the corporation as opposed to paying them out?

Mr. Taylor: I am not sure I understand the thrust of your question, senator.

Senator Everett: I gather from reading the brief that you are concerned about the $2\frac{1}{2}$-year limitation...

Mr. Taylor: Yes.

Senator Everett: ...which would require you to pay out the earnings in one year within a $2\frac{1}{2}$-year period, and you go on to say that while that can be accomplished by a stock dividend that would have the effect—Well, you say that it:

> ...ignores serious difficulties in determining dividend payments in terms of shares, the cost of restructuring corporate capital structures and the depressing effect on equity values.

Mr. Taylor: Yes, we made this comment because we do not think that particular proposal is equitable. We look on an equitable system, for business people, at any rate, as one which extracts the needful amount of tax without forcing artificial distortions, and the normal business practice distinguishes between closely-held and widely-held corporations on the treatment of dividends. For instance, this artificial treatment of partnership elections is one. But when it comes to the $2\frac{1}{2}$-year proposal, what they are saying to the shareholders of the company is that they will penalize the shareholders if payments are not made, and they recognize that the payments are going to be made in what for many companies will have to become an incredibly complex manner, by means of stock dividends.

Take an established company like Hudson Bay Mining which has been paying quarterly dividends for many years. Its shareholders rely on and expect that to continue. I would think that...

Senator Everett: But, ...

Mr. Taylor: If I might just finish this one point, senator—I would think that Hudson Bay Mining will be faced with a completely different type of dividend pattern.

Senator Beaubien: They will have to pay out more, do you think?

Mr. Taylor: Well sir, I do not think it would be possible to continue quarterly dividends. Take a company, if I may suggest, that is paying a total dividend of $1.25 per share per year, are they going to create four separate share issues for each quarterly dividend of 30 cents a share each? They will not, so they will have to approach it differently, and I would think that for most of them the cost of doing this is such that they will end up with a single dividend payment which will not make the shareholders happy. It is an artificial distinction suggested for two reasons, neither of which we agree with.

It is paragraph 4.27 of the White Paper which gives the Government's reasons for suggesting why it must be limited to $2\frac{1}{2}$ years. The first is that they are concerned about corporations storing up these tax credits and the impact on the revenue if substantial claims were made at the end, say, of 10 years. This ignores the fact that most corporations which have been paying dividends will wish to continue paying them and they will not store them up.

Senator Cook: There is another very practical difficulty in the hands of the shareholders which you have overlooked. In other words, you get your dividend every quarter and you cash it because you want to live on it. Instead of being able to cash it, you get one stock dividend of $5 and you have to sell it for $3.50 because you want it to live on. Instead of selling it for $5, it realizes you only $3.

The Chairman: Well, there is a limit to the number of rights issues you can make too. You might run out of paper or reduce the value so significantly it just would not matter.

Senator Everett: Are you not quite content though, in the operation of your company, to retain the earnings for reinvestment, and are not your shareholders content to let you do that, because you do it well and because they have a market for their shares so they can liquidate if they have to do so?

Do you not think there is quite a difference between that and the position of the closely-held corporation? You want to throw out integration.

Mr. Taylor: That is correct.

Senator Everett: It seems you want to throw out integration because what integration is going to do is force you to capitalize your earnings virtually every year, or within $2\frac{1}{2}$ years.

Mr. Taylor: Yes, if we wish to be competitive.

Senator Everett: That is right, if you wish to be competitive. I can understand your reluctance to do that, but you say, "In order to accomplish what we want, let us destroy integration."

Mr. Taylor: Well...

Senator Everett: Let me finish the point. In the case of a closely-held corporation, it seems to me that integration is extremely important because for the minority shareholder in a closely-held corporation there is a limited market, and I agree very much with Senator Phillips that some means has to be given in order to permit the shareholder to capitalize his earnings into a senior security.

I just wonder if you have given consideration to another method of achieving your end. For example, you say you want to be able to move dividends in your corporate structure without tax being imposed through the corporate structure. Nobody can disagree with that. Nobody can disagree with the need of a major corporation to hold its earnings for reinvestment, and it is enabled to do so because there is a market available to the shareholders, but why do you want to throw out something that is so beneficial to closely-held corporations that literally solves one of the most enormous problems that confronts the majority of corporations in Canada? Is there not another way in which you could achieve your end, that would preserve the concept of integration for closely-held corporations and throw it out for widely-held corporations?

Mr. Taylor: May I say two things in response to that statement of yours, senator? We have not suggested that integration necessarily disappears. What we have talked about is the tax-free method of dividends among Canadian resident corporations. There can still be, if you wish, a form of integration at the time the dividend is paid by a Canadian corporation to an individual resident in Canada, or, if it is being paid to the non-resident, at the point of time at which withholding tax becomes applicable. You can still have that sort of integration.

As I understand it, you are talking about the time when payments come into the hands of individuals. Nothing we have said necessarily goes against that.

Senator Everett: Nothing you have said necessarily goes against it?

Mr. Taylor: Not at all. We are talking about the inter-corporate flow of dividends here, and there can still be what you are looking for if this suggestion of ours is adopted.

Senator Everett: You go one step further than that in that you also talk about your $2\frac{1}{2}$-year...

The Chairman: Senator, before you jump to that perhaps we might take a look at the closely-held corporation as defined in the White Paper. What are the disadvantages of any such corporation under the present law?

Senator Everett: Well, first of all, they have to capitalize earnings because there is no market for a minority interest.

The Chairman: But that is at their election.

Senator Everett: No, it is not at their election. It is at Eaton's election, but it is not at the election of the small investor. That is the only way in which he can get into business.

The Chairman: To carry that statement of yours to its logical conclusion, you are justifying the dealing with closely-held corporations and creating all the integration that you have there on the basis that it is going to help the small businessman. It is a pretty big stick to use when there are other and simpler ways of helping the small businessman.

Senator Everett: I am not talking about the small businessman.

The Chairman: I thought you were.

Senator Everett: If you are talking about the lowering of tax then that is another discussion. I am talking about the situation of a closely-held corporation that does not have the ready market of the stock market for its shares. It seems to me that the shareholders in that company have to have a flow-through

of earnings out of the company into their hands. Now, whether that is accomplished by a cash dividend, a stock dividend, or a transfer of those earnings into senior securities, does not really matter. The fact of the matter is that the earnings have to be translated because of our estate tax problem. They have to be translated into the hands of the shareholders, and you know that better than I do.

Now, a shareholder in the widely-held corporation has a market. Earnings can be retained in the company. They do not have to be paid out. The fact that they are retained and reinvested will probably result in an increase in the value of the shares, and the shareholder has a ready market for his shares. The capitalization of his earnings is not as important. All I am saying is that I agree with these gentlemen that, from the point of view of a widely-held corporation, integration under the 2½-year rule imposes a problem. I think that problem should be solved in the same way that the problem of dividends passing through a corporate chain where there are widely-held and closely-held corporations should be solved, and in the same way that this problem of the tax credit that does not permit depletion to pass through to the shareholders, should be solved.

All I am concerned about is that these widely-held corporations are coming here and saying that the way to solve it is to get rid of integration. I am saying there must be another way—a way that solves their problem and that preserves integration in the closely-held corporation.

Mr. Taylor: But, senator, we really have not...

The Chairman: I notice, senator, that you did not answer my question. My question was: What are the disadvantages of a closely-held corporation under the existing law?

Senator Everett: Very well; the disadvantages are that in order to capitalize the surplus you have to pay, if you can, under section 105B a tax of roughly 15 or 16⅔ per cent. There appears to be wide disagreement between tax experts. If you are doing a straight strip—that is, you are going to retain the operation of the corporation and you are going to fund the strip by way of notes or other indebtedness; you are not getting right out and getting rid of the company through a broker, or by way of amalgamation, and so on—there is an indication that that can be attacked by the minister under section 138A. As I understand it, you cannot get a ruling from the minister. If, in fact, section 105B is not available to the closely-held corporation then you are involved in paying dividends on half your earnings, and 15 per cent on the remainder.

The Chairman: Senator, I know you are a lawyer and, therefore, you should know what you are talking about. I am not questioning what you have said, but I would point out to you that when there was this attack on stripping many cases were put to the Income Tax Division, there was an alternative offered to a contest as to whether you had violated the Income Tax Act and were going to be required to pay substantial tax. The alternative offer was that you could settle on the basis of paying 16⅔ per cent.

Senator Everett: But that was offered, I believe—and I stand to be corrected on this—to those who had done the stripping.

The Chairman: That is right.

Senator Everett: I do not think it was offered...

Senator Phillips (Rigaud): It does not have to be offered. The law is there.

The Chairman: Yes, that is right, the law is there.

Senator Phillips (Rigaud): And the rates are much more salutary for shareholders of private companies than they are for shareholders of public companies where the tax rates on dividends are escalated so much, depending upon the bracket in which the recipient shareholder is in. It is the other way around.

Senator Everett: There seems to be disagreement, as I say, as to whether section 105B is available. Some say it is.

Senator Phillips (Rigaud): I suggest to Senator Everett that if he has a problem he should consult a tax lawyer.

Senator Beaubien: A good one.

Senator Everett: The point is interesting. As I say, if you do consult tax lawyers you find that they will disagree on the operation of section 105B. But, even if you do not, there is still a 15 per cent tax imposed. The White Paper proposes to end the 15 per cent tax.

The Chairman: So?

Senator Everett: Then I ask whether you are opposed to the reduction of the tax.

Senator Beaubien: I think that Mr. Gilmour has a comment to make on that.

Mr. Gilmour: Gentlemen, I would point out that the concept in the White Paper of integrating corporate and individual tax is all predicated upon the admission that the problems the authors are seeking to settle is the problem of the family-owned business. The introduction to the White Paper goes to great lengths to describe—and not too completely—the history of legislation in Canada dealing with the members of a family that controls an incorporated business. The solution proposed, in order to give some alleged relief to the members of the family, is that a sledgehammer be applied against all Canadian corporations; that in all Canadian corporations, be they family-owned or closely-held, or public companies, there shall be this great cleavage. It is as artificial as anything can be.

Then, to give relief to the small businessman we have this integration foisted on us. It is to be foisted not only on the family corporation that deserves to be helped, but also on the large public companies, such as Mr. Taylor has been describing.

When considering the proposal on integration in our studies we have realized that the British, who invented the integration system, threw it away as being an inhibition to business expansion. Nonetheless, we are seeking in Canada to solve the problem of the small businessman, because today in Canada that small businessman, through his limited company, will pay an annual tax of up to 52 per cent. Then he has the necessity and the right to withdraw the accumulated surplus of the company by way of dividend into the hands of the family, paying varying rates of tax. History has shown that to get the money out of a company in all the ways that are outlined in our present tax act costs over 60 per cent of the earnings of the corporation in taxes. Therefore the shareholders of the smaller family corporations in Canada have balked at paying a tax of 60 per cent. We have had all these trials in dealing with the so-called surplus stripping, which really attempts to get that money out at between 52 per cent and 61 per cent. It has been in that area that all this litigation and unhappiness has occurred. Certainly, the concept of closely-held and widely-held is a suggestion that to give some alleged relief to the family shareholders everyone in Canada must follow the same theory and our public companies be required to distribute dividends within a two and one-half year period. What is infinitely worse is to require all companies to dispose of accumulated surplus.

This is a vital problem to our little Canadian businessman, who is the backbone of our country. We have to do something to solve it, because he will not pay 60 per cent. One of our proposals is that we will make him pay nearly 90 per cent on his accumulated surplus. This, presumably, is to enable him to gain his future benefit. I do feel, however, in our studies we can narrow our thinking to how to treat the smaller businessman. Years ago we had the family corporation and let these people off with no tax. Personally, I see no reason why that cannot be considered, because we have already extracted 52 per cent from the family business. It is difficult to understand why the public companies should also have this foisted on them.

I am sorry I have talked too long, but I would like to make the point.

The Chairman: I am sorry, Mr. Taylor, but what you said and what developed was really provocative, which is good.

Senator Macnaughton: I refer to page 9, paragraph 6...

The Chairman: We have dealt with part of that with regard to integration. Are there any questions you would like to ask?

Senator Macnaughton: No, I just wanted to try to lead the witness into further explanation. It is very good here but it would be better to have it on the record.

The Chairman: Yes, but I thought of something particularly in paragraph (c) which I would like to have on the record. That is the inadequacy of the incentives offered to the extractive industry.

Senator Phillips (Rigaud): That is included later on.

The Chairman: It is developed, yes.

Senator Phillips (Rigaud): I think the witness is covering three points: integration; secondly, capital gains; and thirdly, the matter of incentives.

Mr. Taylor: We do not have a great deal more to say on the concept of integration. We did not think our suggestions were destroying it for the individual in Canada. We do believe

that the disruptions caused by it to the substantial businesses are such that this concept should be seriously reconsidered.

Senator Desruisseaux: Do you wish the brief to be amended accordingly?

Mr. Taylor: No, we have in each of these individual sections expressed the particular areas. For example, in integration at the opening of the section which concerned us we have developed it and at the end tried to give specific recommendations. Those in integration, for example, you will find at page 13, paragraph 9. Perhaps I could just read them to summarize our views on this one topic.

Senator Phillips (Rigaud): Before you come to that, I think what may be more important than (a), (b) and (c) is what you say in the last sentence at the top of page 13, because we have had other representations on this point. That is a fundamental question of policy with respect to the distribution of profits to shareholders and the structure of the corporation should relate itself to normal, relevant financial and business reasons. You state:

> We do not believe that the tax system should dictate corporate structures contrary to those suggested by relevant financial and business reasons.

Does that sentence include a concept that not only corporate structures are involved, but also policy with respect to distributing profits to shareholders from the point of view of corporate needs?

Mr. Taylor: That is correct, senator. That is one reason why we think this very arbitrary two and one-half year limitation which has been imposed is not acceptable.

Senator Phillips (Rigaud): Thank you, Mr. Taylor.

Mr. Taylor: Mr. Chairman, in summarizing our views on integration we have suggested that:

> (a) corporate profits flow freely through a chain of Canadian companies as is the case under the present system, so that the tax system has a neutral effect whatever the corporate structure may be;
>
> (b) taxes paid by a corporation after the system becomes effective may be fully utilized by resident individual shareholders as a credit against their taxes;
>
> (c) accordingly, consideration should be given to abolishing the artificial distinction between closely-held and widely-held companies. Incentives to small businesses can better be accomplished in other ways.

The Chairman: In paragraph (b) on page 14 are you thinking in terms of the present 20 per cent deduction?

Mr. Taylor: Under (b) on page 14 we are really striking again at this two and one-half year limitation. We do not agree that this artificial concept should prevail. We do not find the reasons suggested for it in the White Paper compelling. The Government seems to suggest that it is quite content to give a credit to the taxpayers in two and one-half years, but it would prefer not to give the same credit for the same taxes in ten years. Most individuals would prefer to be able to defer an obligation for ten years rather than have to meet it in two years.

The Chairman: The White Paper seems to suggest that it is a bad thing to permit companies to postpone payment of their earnings.

Mr. Taylor: This is just not in accordance with better business practices.

The Chairman: It is not in accordance with normal and sound business practice.

Mr. Taylor: The other reason that is suggested for forcing payments within two and one-half years is that there might be some form of trading in companies on substantial tax credits. If this is a problem—I do not know whether it would be—I fail to see why the designated surplus provisions in the present act should not be continued. Under those provisions, in the event of a genuine change in control it has to be shown that the payments have been made out of post-control period earnings.

Senator Phillips (Rigaud): Is there not a strong suggestion in paragraph 4.27 of the White Paper that the distribution of profits by business and industry at large should relate itself to budgetary requirements on the theory that profits are allowed to accumulate over 10 or 15 years? The whole question of retreatment of dividend credits may put the Government figures out of gear.

The Chairman: You mean the rationale that the directors of a company in looking at the

earnings should be aware of the budgetary requirements of the Government?

Senator Phillips (Rigaud): That is right. I would like to read that rather interesting statement in the White Paper, in paragraph 4.27:

> .. if corporations accumulated creditable tax for 10 or 15 years, large dividends at the end of that time could seriously affect government revenues in the year of distribution. Further, the rule would limit the amount of creditable tax in any given corporation at any given time and so reduce the temptation to taxpayers who cannot make use of creditable tax to "sell" it to taxpayers who can make use of it.

This is an observation in the White Paper that I find unique, that the problems of business and industry, and generally the problems of taxpayers in the country with respect to distribution and receipt of dividends, relate themselves to the budgetary problems of government.

The Chairman: When you read part of this I was trying to figure out how, if you accumulated dividends, profits, for ten years and then paid them out in one year, that would seriously affect government revenues in the year of distribution. It would increase them.

Senator Phillips (Rigaud): It would increase them. I had thought of that. You are absolutely right. I think they are referring to tax credits involved by the huge accumulation if the two and a half year rule were eliminated with respect to distribution; they forget the offsetting net tax available in the hands of the shareholders.

The Chairman: They are also forgetting the non-use of the tax credit in the years in which the dividends are not paid out.

Mr. Taylor: In fact, they are paying back in depreciated dollars for this ten-year period.

The Chairman: Would you go ahead, Mr. Taylor.

Mr. Taylor: If I may turn to the next section in our brief, commencing on page 15, dealing with capital gains, here, as we point out at the beginning, we have areas of concern arising from the closely-held and widely-held distinction, the taxation of unrealized gains every fiver years, the taxing of recoveries of cost when value on valuation day is less than cost, and the vagueness of the roll-over provisions dealing with gain on corporation reorganizations, where in many instances what are truly unrealized gains will be taxed, and the proposal finally to tax non-residents on gains in shares of closely-held companies and on realized and unrealized gains on shareholdings in excess of 25 per cent interest in widely-held companies.

I may say that when we say we are concerned about this, and certainly with respect to the very last comment I made, we are really making an assumption based on some rather vague language in the White Paper. You cannot specifically find language where the authors have said they intend to tax non-resident shareholders who hold more than 25 per cent of a widely-held corporation on this five-year revaluation basis. It is an assumption that we and other commentators have drawn from the language of the White Paper.

The Chairman: Is that an assumption you have drawn, Mr. Gilmour?

Mr. Gilmour: It seems reasonably clear in the White Paper that those are intentions, because there are very specific paragraphs that state they will tax non-residents, such as Mr. Taylor has quoted on page 15, in paragraph (e). These are almost direct quotations from the White Paper. How the enacting legislation will read is anybody's guess.

The Chairman: Which paragraph is that?

Senator Macnaughton: In that respect, on page 17, paragraph 7, the witnesses are quite definite. For example, they say:

> The aspect of the proposals referred to has no counterpart in any other major tax systems.

I wonder if in due course the witness could develop his thought as outlined in paragraph 7 on page 17.

Mr. Taylor: Mr. Chairman, I think your question was directed to paragraph 3.33 of the White Paper. That is where the first reference comes to this.

The Chairman: Paragraph 6.47 says:

> Also, it would be impracticable to attempt to tax non-residents on their sales of small lots of these shares.

That is talking about widely-held corporations.

> Therefore it is proposed that only those non-residents who are selling shares out

> of a substantial interest (25 per cent or more) would be taxable in Canada.

That is dealing with capital gains.

Mr. Taylor: That is true, Mr. Chairman, but our concern also relates to this proposed five-year revaluation, and paragraph 6.47 seems to talk just of sales, actual gains. It is really, I think, an inference that at least other commentators have drawn from the language of paragraph 3.33, that somehow the Government has it in its mind to force revaluation for non-resident shareholders who hold more than 25 per cent interest. You cannot be explicit to the line.

The Chairman: For tax payers other than widely held corporations, that exemption is theirs except for the special rates.

Mr. Taylor: That is right.

Senator Isnor: I wonder if Mr. Gilmour would throw a little more light on page 15 of section D, the proposal of acts of non-residents on gains and shares of closely-held companies. Are there many such companies?

The Chairman: Have you any idea of the number of closely-held companies that there might be in Canada?

Mr. Gilmour: There are no statistics I know of, senator, that give you any indication of the closely-held corporations. We do know that there are approximately 82,000 corporations with taxable income of less than $35,000. There are approximately 10,000 corporations with taxable income in excess of the $35,000. Actually, the after-taxable income of those 10,000 corporations appears to be in excess of about $350,900, which is the after-taxable income. Therefore, our widely-held corporations would ordinarily fall within the 10,900 corporations in Canada.

Senator Isnor: I do not mean widely-held. My question was...

The Chairman: He knows that. He told us that there are no statistics available.

Mr. Gilmour: There are probably at least 80,000 closely held corporations. Then there are perhaps 2,000 or 3,000 more corporations with larger incomes that probably are also closely-held. The definition of closely-held really means a company that is not listed on one of our stock exchanges. Consequently, it has nothing to do with size. There are very few of our family corporations. Some of our very largest family corporations are listed. Although they are family-owned, they would still be classified as widely-held. Most of our family corporations, which amount to possibly 80,000, are not widely-held. We can only infer what the numbers are.

Senator Carter: Do I understand Mr. Gilmour to say that any company that is not listed on the stock exchange with shares available to the public is a closely-held corporation?

Mr. Gilmour: Generally, yes.

The Chairman: That is discretionary in the judgment of the minister. The test would be if you are listed, but there may be some that are not listed and in his discretion he might decide they are widely-held. I would think they might look at the number of shareholders and possibly relate it to the private company, however, I do not know. In a private company, the limitation is not more than 50 shareholders and they might relate it to that. If you had a company not listed, but had 100, 200, or 1,000 shareholders the minister, under the proposals, would have the right to say that you are a widely-held company.

Senator Macnaughton: I do not want to bore the committee, but we have a very important corporation here and very capable witnesses and it seems to me that they should have read into the record paragraph 7, which seems to be their considered opinion based on a great deal of experience. The record will count in the long instance.

The Chairman: Page 17, paragraph 7. Would the witness care to do that, if that is your considered opinion?

Mr. Taylor: It is. Paragraph 7 states:

> The proposals regarding the taxation of gains by non-residents will have a detrimental effect on investment by non-residents, particularly residents of countries which have no capital gains tax or which provide no credit for foreign taxes, or if the Canadian tax imposed exceeds the rate of tax abroad. The aspect of the proposals referred to has no counterpart in other major tax systems. We doubt that the Canadian government will be able to renegotiate treaties which will effectively avoid the double taxation of capital gains. For these reasons we are opposed to taxing non-residents on Canadian gains.

Senator Phillips (Rigaud): You should say on Canadian capital gains, because the heading of your section is on Canadian capital gains.

The Chairman: I do not think the negotiation of new tax treaties is going to be done with the ease that the White Paper suggests. I think it is going to be a long process and I can see, in many areas, where other countries would be asked to give up too much and therefore would not negotiate.

Senator Macnaughton: I was particularly interested in the detrimental effect of investment by non-residents.

Mr. Taylor: I think this is one of the very serious effects of the proposals in the White Paper. The proposal to tax non-residents on non-realized gains was literally unheard of until now and we have seen in our earlier discussion on Interlink that this is one of the reasons why it would be forced to liquidate. I think it would be a reasonable conclusion, sir, that other people who are just potential investors in Canada would hesitate for the same reason. It does not seem like a fair approach.

The Chairman: Senator Phillips can correct me if I am wrong, but my recollection is that in the tax treaty between Canada and the United States, if a Canadian makes a capital gain in operations in the States, he is not subject to the capital gains tax in the United States.

Senator Phillips (Rigaud): It is specifically exempt in the early part of the treaty.

The Chairman: I was excluding the existence of a permanent establishment in the United States. If he makes a capital gain in the States, he is not subject to capital gains tax, which is part of the law in the United States. Now, if you have a capital gains tax in Canada and one in the United States, the question is how are you going to negotiate your tax treaty then? What happens in those circumstances? The United States might decide, since the profit was made in the USA and we can tax it and it is a legitimate source of tax under our law, that you may have a capital gains tax in those circumstances imposed in the United States. Then, when the man brings the remnants home he may have to account for capital gains here. I realize that a tax treaty can supersede the provisions of the Income Tax Act.

Mr. Taylor: It has also been suggested, Mr. Chairman, that this renegotiation of treaties really depends upon the date on which you negotiate the last of them and not the first of them, because as long as there is one held out, which is a country with which we have an existing treaty, people with a sufficient amount of money and imagination can restructure their affairs abroad and deal through that country.

Senator Laird: Yes.

Mr. Taylor: Our approach to capital gains reflects our attitude towards closely held and widely held companies. We do not think there should be a distinction between the two for tax purposes, certainly not in the concept in which we are talking, that of small businessmen. Accordingly, we think that the rate of gain should apply whether it is the shares of a small company or of a large company, and at the same rate, and we suggest that if there is to be a capital gains tax, it should be a tax based on the length of time that the gain has accrued. So that, in essence, a man who could make a million dollars in the stock market in a week would be taxed on that as though it were ordinary income. Whereas a man who has held on to an investment and seen it mature slowly over five or ten years would be either exempt or would be taxed at minimal rates. And we can see that perhaps one could have a three-tier structure—something over five years being either exempt or at low rates, something between six months and five years being taxed at less than the ordinary income rates, and something within the shorter period being taxed as though it were ordinary income.

We tried to see if it were possible to suggest a definition as to what might be considered a capital gain as such, rather than dealing with it as we are suggesting on a time basis; but we found it beyond our ability in the time we had.

Senator Laird: In the illustration you gave of the man making a million dollars on the stock exchange, under the present state of the jurisprudence there would be no escaping income tax liability.

Mr. Taylor: I would think so.

Senator Laird: This is obviously an adventure or concern in the nature of trade. That was decided in the case of *Edwards versus Bairstow*.

The gain on the stock exchange transaction would be taxed as taxable income.

Mr. Taylor: That might refer to a particular case, but traditionally, as I understand it, gains made on the stock market, by a non-professional trader such as perhaps yourself or myself, would not be taxed.

Senator Laird: That is not so, in my humble opinion. There have been discussions on this in the past. The departmental officials have admitted that it was the difficulty of departmental administration which prevented them from enforcing the law. The law is there if they wanted to take advantage of it. It is a gain in the nature of trade, even though it is an isolated transaction.

The Chairman: There would be a lot of factors to be looked at, how long the stock was held, how you went about disposing of it.

Senator Laird: Yes, but I would say it is 99 to 1 against you, in the illustration given by the witness.

Mr. Taylor: One might suggest the witness made too much money.

Senator Laird: And too fast.

Mr. Taylor: And too fast.

Senator Carter: Before we leave this sector, I wonder if the witness could give an illustration of what he had in mind in paragraph two on page 15. He says:

> . . .we can see no logical reason for subjecting gains on sales of shares of either type of company to tax a different rates, and consider that many artificial situations will be developed to take advantage of the lower rate.

I wonder if he could give an illustration of what kind of artificial situation he had in mind.

Mr. Taylor: I am not sure I can give you an exact illustration of that at this moment. This reflects still our belief that ordinary business considerations should be kept in the forefront and that tax devices should not be the thing that becomes important.

This is why we do not want a distinction in treatment on dividends between closely held and widely held corporations.

Equally, we think it would be a bad tax system which perpetuated a distinction in rates of tax between closely held and widely held companies.

While I cannot at the moment give you an example of that, I am sure that people will spend a great deal of time and ingenuity trying to fit this into a cheaper tax rate, if it exists. We do not think that is an advantage. We do not think there is any necessity for it. We are trying to keep it simpler, or suggest a simpler form of approach.

The Chairman: We can turn now to page 19. This is a new sector.

Mr. Taylor: This aspect of the brief deals with our concern about the White Paper proposals which affect the extractive industries. We point out the increased burden of the combined provincial and federal taxes on the extractive industry, the reduced value of the incentives granted to the extractive industry as a result of integration, the lack of assurance that capital will be fully recovered before taxation, the restriction of the "earned depletion" allowance to capital expenditures relating to new mines but not to the expansion of existing mines.

There are certain inequities of the transitional provisions restricting the depletion allowance to properties owned at the time of the publication of the White Paper. Generally, these incentives, as we see them, will be inadequate to encourage the further development of Canada's mineral resources.

Dealing with these effects, as we see them, we have come up with a series of proposals and comments. I do not want to be repetitious, Mr. Chairman, about this and if honourable senators are familiar with the brief, it might be more simple to answer questions.

Senator Phillips (Rigaud): When we had the Noranda people before us, dealing with the whole subject matter of incentives, speaking from memory—I reserve myself on that, as I have not got the exact answers to the questions—there emerged two answers from the Noranda people on the subject matter of the reaction of the mining industry at large to the proposals in the White Paper.

One was that there had resulted immediately from the time of the tabling of the White Paper, a retardation of the flow of foreign capital into the country, from the point of view of exploration and the like, and from the point of view of extending further activities of already existing companies. That was one answer.

The second answer was that the overall value of the Noranda picture at large I think

was impaired to the extent of about 40 per cent.

I do not want you to comment on Noranda, but I would like you to comment on the two subject matters in relation to your own company or set of companies.

Mr. Taylor: I cannot give this committee at this time a specific example within the group where there has been a retardation of foreign capital for purposes of exploration or even for investment. I can say that, as we mentioned before, if we were to examine the Baffinland project, which we have discussed, in the light of these proposals, we would see that there is a substantial adverse effect on the return to the shareholders, and a substantial adverse effect on the company itself.

We have not done precise figures, but, if they don't produce a satisfactory discount of cash flow, then it is unlikely that there is any reason whatever for proceeding with that project, and yet it is one of value to the economy.

Senator Phillips (Rigaud): Have you had any reactions from financial underwriting houses and bankers, generally, with respect to the adverse effects on exploration, say, of this particular venture? Or is it your own conclusions that you are giving us?

Mr. Taylor: We would have to say that this is our own internal conclusion at this stage.

Mr. Risby: If I may add one comment, Mr. Chairman, if we were to follow this through with respect to just our own, one company, it would probably be to say that, like Noranda, after our net return we would, by comparison to what we had expected in coming into Canada, probably be 30 per cent low. The effect of this creditable tax on our mining investments is not flowing through. Our figure would be about 30 per cent.

Senator Macnaughton: Mr. Chairman, would the witnesses agree that it is sort of general knowledge that there has been a decided increase in interest of non-resident investors as to what is going to take place, what their future position should be? In other words, non-resident investors are decidedly disturbed.

Mr. Taylor: They are decidedly disturbed and they are waiting, because there have been some suggestions that this is a bargaining paper put forward by the Government and that not all of the proposals will be implemented. But when you are dealing with the very substantial capital requirements of a new mine, you really want to know what the exact position is—not what, hopefully, it might turn into.

The Chairman: No, you cannot operate on uncertainties.

Mr. Taylor: You cannot finance on them.

Senator Macnaughton: It is a matter of confidence.

Mr. Taylor: That is right, and at the moment the picture is extremely cloudy.

The Chairman: How would you assess the difference in dealing with depletion—in the present law as compared with what the White Paper proposes?

Mr. Taylor: I think our fundamental approach to depletion and the three-year tax exempt period is that they are all part and parcel of one particular aspect, and incentive to an investor to put money into an extremely risky enterprise in the hope that there is a mine somewhere out there. And really, in our view, it does not matter which one you choose to give to a shareholder, if you are going to give him anything at all. We think that there are distinct advantages in retaining one or the other of the traditional forms of incentives, because they are understood and because people who have had them in the past and have invested in the past and want to invest again in the future know the animal with which they are dealing.

The Chairman: Are you saying, then, that one or the other of the existing incentives, either a tax holiday or a depletion should be retained?

Mr. Taylor: Yes.

The Chairman: I think Noranda favoured the depletion.

Mr. Taylor: Well, I think we favour retention of depletion allowances, sir, because there are proposals in the White Paper to enable a company to obtain the return, if you like, of part of its capital requirement—not all of it, but a part of it—before tax becomes payable. So that the three-year tax holiday, I think, could disappear under those circumstances, if it could be seen that the capital requirements for a new mine up in the wilderness could be recovered before taxes became payable. Now, the Government's proposals suggest that an investor will be,

and I am quoting, "pretty well assured" that he will get his capital back before any taxes are payable.

The Chairman: That means, doesn't it, that the company will get its capital back?

Mr. Taylor: That is right, and, in fact, the class of assets referred to as providing this benefit is by no means all inclusive. We have pointed out in the brief, for example that, viewing our Baffinland project again, of the $100 million only $48.4 million would qualify for accelerated depreciation and earned depletion. That is page 22 of the brief, Mr. Chairman. That is less than one-half of the total capital commitment required. So it is hard for us to accept the statement in the White Paper that the investor can be "pretty well assured" that he will get his money back before taxes are paid.

Senator Cook: Mr. Taylor in paragraph 2 on page 19 you say that:

> The proposals ignore the burden on the mining industry of provincial taxes. Unless a credit is granted for provincial taxes the extractive industry will be subject to a tax burden in excess of that imposed on industrial companies.

Do you read the White Paper to indicate that you will not be able to deduct the provincial taxes?

Mr. Taylor: You can't now.

Senator Cook: You cannot now?

Mr. Taylor: No. Really, the provincial mining taxes, sir, are a tax on profits. It is on income.

Senator Cook: But there are royalties.

Mr. Taylor: Yes, there can be royalty taxes payable as well, but you are allowed to deduct them as an expense in computing your taxable income for federal income tax purposes. You get them as a deduction. But what we are suggesting is that they should become a credit against the federal income taxes payable; not a deduction, but a credit.

Senator Cook: My question was, do you read the White Paper now to provide that you will not be allowed to deduct?

Mr. Taylor: No. I misunderstood your question. We do not read it in that way.

Senator Carter: Is there any clear line drawn between an expansion of a mine already in operation and a new mine? If, for example, you were operating a mine in an area and found a body of ore a mile from your operation, would going after that new body be regarded as an expansion of the operation in the area or could it be classed as a new mine? In other words, do you have to start from scratch in order to be classified as opening a new mine?

Mr. Taylor: You have to make your peace with the department, sir, as to whether or not they will agree that it is a new mine. It is a matter of fact and it is a judgment decision. Occasionally there are difficult judgments to make, but there is no hard and fast rule for it.

Senator Everett: Mr. Taylor, on page 20, item 6, you state that:

> The proposals perpetuate, perhaps unintentionally, one of the defects of the existing system. A company which spends more than one-half of its profits before eligible expenditures are deducted, is denied a deduction in that year of all the depletion it has "earned".

I understand what you are getting at, but I wonder if you could give us an example of how it actually operates.

Mr. Taylor: Well, perhaps I could just read paragraph 5.39 of the White Paper to you, because it is related to this and it is a short paragraph.

The Chairman: Yes, go ahead.

Mr. Taylor: Paragraph 5.39 reads as follows:

> 5.39 A second inefficiency is also related to the fact that the depletion allowance applies to all production profits without limit. Because exploration and development costs must be deducted in computing production profits for this purpose, the operator of a mineral resource can logically claim he is inhibited from engaging in exploration by the rules concerning depletion. The exploration costs reduce the depletion allowance: therefore it can be argued that the provision designed to increase exploration can in some cases reduce it.

This is a defect which I am sure the committee will have many representations about is continued under the existing system. Whether it is earned depletion or percentage depletion you are up against exactly the same problem.

Senator Everett: I am wondering how it works on your statement if you spend more than one-half of your profits...

Mr. Taylor: Well, you can in fact see how that works out in a specific example given in paragraph 5.41 of the White Paper where such a specific example is given. This is an example of the effect under the new system. You will see that there they take it just at the half-way mark. It shows a profit of $6,003 before eligible expenditures and they have assumed eligible expenditures at $3,000 and the maximum depletion you can get is one-third of what is left over, so that the more you spend on your eligible expenditures—that rises to $4,000—the less amount is left for you to have by way of earned depletion.

Senator Everett: I agree with that, but I just do not see how you make your statement that if you spend one-half of your profits you are denied the deduction in that year of all the depletion it has earned.

Mr. Taylor: The example in paragraph 5.41 illustrates that.

Senator Everett: That is what I don't understand.

Mr. Taylor: What we are saying is that if your profits before you look at these so-called eligible expenditures on exploration are looked at and you get $6,003 in profits there, and then you deduct the eligible expenditures of $3,000, which is just at the half-way mark, you can then earn a maximum depletion of $1,000.

Senator Everett: But you say you are denied a deduction for all you earn.

Mr. Taylor: If you spend $4,000, the maximum depletion allowance is one-third of what you have spent, that is one-third of $3,000. That is the most the company can get by way of earned depletion.

The Chairman: If you spend $3, you earn $1.

Senator Leonard: I think the phrasing is a little ambiguous. What you really mean is that there is part of your depreciation that is disallowed.

Mr. Taylor: That is right, sir.

Senator Leonard: Rather than all the depreciation for one year.

Mr. Taylor: You cannot take in that year the full amount with respect to money you have spent.

Senator Carter: You cannot get full depletion, but you can get some. This is at the top of page 21. All your depreciation is not actually denied.

Mr. Taylor: I think the words are literally true. I said it denies a deduction in that year of all.

The Chairman: Is there anything else or have you got pretty well to the end of your submission.

Senator Phillips (Rigaud): I have just one question, Mr. Chairman. This deals with the alleged rationale for this $1 for every $3 of eligible expenditure. Have you any alternative suggestion? I am referring now to page 21, paragraph 7. We put the same question to Noranda.

Mr. Taylor: We have not been specific except to say that we think it should be on more favourable terms, and I do not think that we are today in a position to suggest one for one, and you can work in any gradation between there and three for one proposed and improve the situation to some extent. We are more concerned about the full recovery of capital costs, and we are more concerned about the loss of effectiveness of incentives to the shareholders when dividends are paid.

Senator Phillips (Rigaud): You do not seem to be too much concerned about the elimination of the tax holiday.

Mr. Taylor: No, sir, provided there is a return of all the capital. If that is available, I do not think there is a logical justification any more for a three-year tax holiday unless you want to give a general type of incentive.

Senator Phillips (Rigaud): You think that relates itself more to high government policy on the movement of capital into the country than as related to the needs of the industry as such?

Mr. Taylor: That is right.

The Chairman: On the question of the tax holiday, first of all it does not mean anything unless you make money, and the privilege to write off does not mean anything unless you have something to write off against. Now let us assume that the tax holiday is gone and it means that from the time the company enters into what might be called normal mining

operations—and they give them a running period of maybe six months—then you would be entitled to write-off against your production profits, depreciation and pre-production expenses.

Mr. Taylor: That is right.

The Chairman: And the only limit on the pre-production expenses would be the amount of dollars that you earn. Your depreciation might have rates attached to it.

Mr. Taylor: This is what we are arguing against, of course. And we are suggesting you should be able to take into account 100 per cent capital cost allowance against your income.

The Chairman: I mean to the extent that you earn income, the first charge against it until you have fully recouped yourself should be the return of the amount of the capital you have in there plus your operating expenses.

Mr. Taylor: Yes, that is just to get your capital return. Unless you get your money back, there is no incentive. So it is in addition to that that we say the company should with respect to certain types of expenditure have earned depletion as well and that somehow the benefits of this earned depletion should accrue, not just to the company, but to the investors—the shareholders.

Senator Leonard: Is there any real relationship between exploration expenditures—is there any necessity to tie them in or any logical reason to tie in a depletion allowance to the company with earning some allowance with respect to exploration expenditures?

Mr. Taylor: I can see the justification for it, sir.

The Chairman: Before you go into that or before you go that far, just wait a minute. The concept of depletion is giving to the shareholders something and giving to the company something to replace the property that has wasted.

Senator Leonard: What is his justification?

Mr. Taylor: I think the theoretical justification is that they are trying to encourage people to look for more and more resources. Now if you are treating this as an incentive purely as opposed to what the chairman was suggesting a moment ago, you are ignoring that aspect about having a waste of resources and you are considering that depletion of this sort is purely to encourage the finding of new mines, and on that basis I can see, if that is the Government's policy, it being tied in some fashion to the amount of money you are willing to spend to find new mines. I am not saying I agree with that, but you asked me if there was a logical connection, and I am trying to give you one.

The Chairman: I take it you do not agree with it?

Mr. Taylor: That is right, I do not.

Senator Macnaughton: Mr. Chairman, there are two items I do not think we have touched on: on page 25, the mobility of skilled technical personnel; and on page 26 advance tax rulings. They are both very interesting.

Mr. Taylor: Mr. Chairman, I think I can deal briefly with the problem of temporary residence. It is a matter which affects our group in terms of the non-residents coming to Canada, where their skills are required for a temporary period and it is not their intention to become citizens. They may be here three or five years and the bulk of their assets remains in their homeland. We think it an inequitable proposal that they should be taxed, purely because their employer requires them to come to Canada, on gains which accrue outside the country. We are not suggesting that if they bring their assets here and employ them here and there is a gains tax here, that they should somehow be given a preference on those gains, but we say that if they choose to leave their assets behind them that should be a matter of indifference to this Government for revenue purposes.

Senator Macnaughton: They may refuse to come.

Mr. Taylor: Well, if they do not refuse to come, I imagine the cost to their employer will rise to take this factor into account and, of course, it also raises the obvious problems of enforcing such a provision as this. You do not really want to talk about that, but I can see great problems in seeing to it that the people will be honest with the Canadian Government if there is such a law.

Senator Macnaughton: What about the advance tax rulings?

Mr. Taylor: If we are to be faced with capital gains, and it appears we may have a capital gains system in one form or another, then we are concerned, as we mentioned earlier, that the treatments afforded business

reorganization in the White Paper are pretty scanty. There will have to be some rather complex rules because, quite apart from the situations referred to in the White Paper, we think there should be other instances in which there would be, as the American phrase is non-recognition of gain, and that you should be able to get, and be sure of getting, an advance tax ruling for that purpose. Right now it is a matter of discretion whether you get a ruling or not. We think that if the Government intends to implement a gains system it should be prepared to give taxpayers advance rulings.

Senator Phillips (Rigaud): You are thinking of a system similar to that in the United States, where you get the necessary stipulations?

Mr. Taylor: That is right. You give them all the facts, and if you deviate from those facts the ruling is worth nothing.

The Chairman: Do you feel you have added everything you would like to?

Senator Cook: There is just one question on the very last paragraph on page 27, where you say:

> We believe that implementation of the White Paper proposals will result in a less attractive climate for foreign investment in the extractive industries, and will materially and adversely affect the Canadian economy as a whole.

You would not limit it to foreign investment, would you? It would be less attractive for Canadian investment as well.

Mr. Taylor: We do not limit it in that way. In our brief, of course, we were attempting to reflect the fact that our principal shareholders are non-resident, but I agree with what you have said, that it has an overall impact and is not confined to non-residents.

The Chairman: Mr. Taylor and Mr. Risby, thank you very much.

We have another brief to consider and I think we should start on it. It is that of the Council of the Forest Industries of British Columbia. We have with us: Mr. Gordon L. Draeseke, President and Chief Executive Officer; Mr. Colin Warner, Chairman of the Taxation Committee; and Mr. Dennis Stead, C.A.

Who is going to be the spokesman?

Mr. Gordon L. Draeseke, President and Chief Executive Officer, Council of the Forest Industries of British Columbia: I will be the spokesman, Mr. Chairman, and I would like to call on these technical men on technical questions, if I may.

The Chairman: Yes. Do you have a summary of your brief? I assume your brief has been read by senators.

Senator Macnaughton: Are we continuing this afternoon?

The Chairman: If we do not finish this morning. It depends how long we may be on this brief.

Senator Beaubien: How long do you propose to go on now?

The Chairman: I thought we would go on for another half an hour.

Some of the points that occur in this brief have already been developed, though the industries are not related. Would you care, in your summary, to deal with the points that particularly concern your operation?

Mr. Draeseke: Yes, Mr. Chairman. Could I just say a few words to put our brief in perspective and to highlight the points that concern us?

The Chairman: Certainly.

Mr. Draeseke: Our industry in British Columbia incurs all its costs in Canada and exports 80 per cent of its production. In 1969 production was \$1-1/2 billion and exports were \$1.2 billion. While these figures are large to us, they represent only 4½ per cent of the lumber and 1 per cent of the pulp and paper consumed in the world. Because these products are mostly free-traded, the prices obtained are world levels governed purely by supply and demand. We cannot influence the price, so we must lower costs, which simply means more investment in productive machinery. This has been the thrust of our business for several years now. We are next to Washington and Oregon and we have to pay comparable wages to get sufficient skilled labour, but our productivity is 20 per cent below theirs. It is therefore not surprising that they are cutting more than we are from a smaller forest. Our forest could support twice our present volume. Here is where we are deeply disturbed because fiscal policy in Canada already keeps the potential flow of new equipment into our operations at little more than one-half of theirs.

Canada's per capita productivity was second in the world in 1960, slipped to third in 1964, and Japan's Economic Research Centre predicts it will slip to fourth this year and sixth in 1975. The United States remains No. 1 throughout. We are sliding down the world scale under existing policies, and parts of the White Paper would accelerate that slide.

The Chairman: Now would you just break this down and tell us the parts of the White Paper that would accelerate that slide, because I notice as well you have general subject matter.

Mr. Draeseke: Yes, that is right.

Senator Isnor: Before you touch on the White Paper, would you give the reasons why you think you are sliding down?

The Chairman: Would you give the reason why productivity is slipping?

Mr. Draeseke: Yes, I would be glad to. This can best be illustrated by an example which I have brought along, and perhaps I could pass out these copies. I think this document illustrates what we are talking about. I mentioned in our introduction that we are competing with Washington and Oregon, and our problem is in keeping our costs low by increasing productivity. This is the present situation in Canada that I am going to demonstrate now, and not the effects of the White Paper.

On the front page of this document you will see a summary of the cost of putting a typical piece of modern equipment into a logging operation in British Columbia, and you will see that it takes almost seven years to get your money back. If you do the same thing in Oregon, it takes you 3.6 years to get your money back. Therefore, our companies are only able to afford a little more than half the flow of productive equipment. This, as I say, is the present situation. We think the proposals in the White Paper are going to make this worse, and not better.

It is a fairly complicated calculation in this example, but these figures are taken from the internal records of one of our members, and it shows what the pay-back is when you put money into productive equipment in the industry in the two countries.

I do not know whether you want me to give all the details of it, but I shall be glad to if...

The Chairman: No, we can quite easily read it. You have stated the result.

Mr. Draeseke: The result is shown at the bottom of the first sheet. The second sheet contains a back-up of the calculation.

The Chairman: If you install this equipment in Oregon then the pay-back would be completed in 3.6 years, and in Canada the pay-back would be in 6.9 years?

Mr. Draeseke: That is right.

Senator Phillips (Rigaud): That is under the present law?

Mr. Draeseke: Yes.

Senator Phillips (Rigaud): I take it that it is not only caused by the application of the law, but also by the productivity of the workmen.

Mr. Draeseke: No, the productivity of the workmen is the same in both countries. This is the result of the fiscal policy of Canada—tariffs, sales tax, income tax, and logging tax.

Senator Phillips (Rigaud): I was about to say that that is plus the B.C. tax.

Mr. Draeseke: That is right, everything is included.

The Chairman: Does that answer your question, senator?

Senator Isnor: Yes, to a certain extent.

Senator Leonard: I am not sure that it does answer Senator Isnor's question. I think his question was related to productivity.

Senator Isnor: Yes.

Senator Leonard: I assume you were talking about the productivity of labour.

The Chairman: I asked that question, and he said...

Senator Leonard: This document has nothing to do with productivity.

Mr. Draeseke: I am sorry, but perhaps I misunderstood the question. I thought you were asking why we could not improve our productivity.

Senator Isnor: Well, I did not use the word "productivity", but...

Mr. Draeseke: If you want a comparison of productivity as between the two countries, then I have that. This document shows a difference of 20 per cent. I have the detailed calculation of that if you would like to see it as well.

Senator Leonard: Yes, I would.

Mr. Draeseke: This single sheet shows the statistics for the last six years.

Senator Leonard: Is that gap of 20 per cent widening, or is it stationary?

Mr. Draeseke: It seems to fluctuate. You will realize that any comparison of productivity between two countries is difficult because of different conditions. What we have done is to take the overall board-foot production per man-year based on the various statistics avilaable to us, and which are shown at the bottom. It can be seen that in 1963 the difference was 19 per cent; in 1964 it was 24 per cent; in 1965 it was 26 per cent. It dropped to 16 per cent in 1966, to 12 per cent in 1967, and then rose to 17.3 per cent in 1968. The average for the years is 19.4 per cent.

I think that weather conditions in the various areas have a great deal to do with the different results in different years. There are varying weather conditions as between Washington, Oregon, and British Columbia, and particularly the northern part of British Columbia.

Senator Leonard: And does the efficiency of the use of capital equipment have something to do with the production of board-feet per man year?

Mr. Draeseke: I would say that equal pieces of equipment are used just as efficiently in the two countries.

Senator Leonard: So in that case this differentiation is caused purely by the labour cost.

Mr. Draeseke: This is the productivity of the labour, but our industry is capital intensive, and there is not really that much difference in the efficiency of the workman as a person. It is a difference in the tools that he has that is the important item. My point is that under our present fiscal policies we are unable to equip our workmen as well as our competitors in the United States.

The Chairman: May we proceed now to the parts of the White Paper that you think will accelerate this slide, as you call it?

Mr. Draeseke: Yes. The first item is that the imposition of a capital gains tax in its proposed form would seriously impair the amount of capital funds generated, which are necessary for investment in equipment. However, if it is absolutely essential to Canada's revenue requirements that these gains be taxed, we submit that it should be at a low rate which will not impair the generation of capital.

Secondly—and this particularly refers to our industry in British Columbia—small companies have greater difficulty in the raising of capital for growth than do large companies. The profits now reinvested to provide growth capital would be substantially reduced if the low rate of tax was removed. We are referring here to the tax on the first $35,000. The small company must not be deprived of this or an equivalent incentive.

I should point out that in our industry in British Columbia we are heavy to small companies. We have 2,330 logging camps, 1,141 sawmills, and 255 combined sawmills and camps, in the province. That is a total of close to 5,000 individual units. The statistics that have recently come to hand, issued by the Department of Finance, show that the proportion of companies in British Columbia earning under $35,000 is higher than it is in any other part of Canada.

In addition, we are dependent upon world markets. Years are good and years are bad. During the period of the marginal profits it is important that the companies' cash flow be kept as high as possible to allow the reinvestment in productive equipment. The proposals in the White Paper would have the effect of producing personal and corporate savings. This is stated as a fact by Mr. Bryce in his evidence before the house committee.

The Chairman: And here.

Mr. Draeseke: And here, when he said that savings by the small companies would be reduced and revenue to Government would be increased in the amount of 4.5 per cent of total revenue. We feel that the diversion of the earnings of these small companies, which all have potential for growth in British Columbia, into Government revenue would be a very poor use of capital compared to allowing that company to make its investment decisions based on local knowledge to produce something which is sold in export markets. Therefore the whole thrust of the White Paper would simply reduce our ability to accumulate capital and improve productivity. I believe that covers the question, Mr. Chairman.

The Chairman: Is this the only factor? There are other factors that are accelerating your slide.

Mr. Draeseke: As far as the productivity argument is concerned this is the main point.

The Chairman: No, I mean the influence of the White Paper?

Mr. Draeseke: I feel that this business of capital accumulation is by far the most important as far as the White Paper is concerned. There are other factors which impinge on it to a small extent. These are the five year revaluation, which we refer to in our brief and the two and one-half year rule.

The Chairman: We have developed those aspects earlier today.

Mr. Draeseke: We have covered both in our brief. We point out that the five year revaluation is unfair to one type of company as opposed to another. There are companies in our business which are wholly-owned American subsidiaries and come under the closely-held. Another company has a minority of Canadian shareholders and comes under widely-held, with different classes of treatment, although they are perfectly parallel competitors.

The Chairman: That is within the membership of your association?

Mr. Draeseke: Yes, within our association. In other words, a more familiar example would be along the lines of General Motors of Canada which has one shareholder, whereas Ford is widely-held, yet they are straight competitors. We have the same situation in the forest industry in British Columbia.

The Chairman: What is another aspect?

Senator Phillips (Rigaud): In paragraphs 5 and 6 you refer to this hard core, as it has been previously described, in the White Paper, the method of treatment of the handling of dividends, capital gains, and so on. At the top of page 6 you take the position that:

> The implementation of the creditable tax system will be unbelievably complex to comply with and administer.

Mr. Draeseke: Yes.

The Chairman: They quote almost the same language that Amcan used at the bottom of page 5 of their brief.

Senator Phillips (Rigaud): Yes.

Mr. Draeseke: Reading on:

> The $2\frac{1}{2}$ year rule or any substitute should be abandoned because it would unnecessarily cause serious interference with the determination of corporate dividend policy and impose corporate growth restrictions.

Senator Phillips (Rigaud): That is on all fours with the Amcan statement.

Mr. Draeseke: That is right. We go on to say, under Administration:

> The current proposals (not specified in the "White Paper") for the transitional period will add immeasurably to the complexity. The proposal to divert corporate tax to non-creditable tax pools represents in effect the taxation in advance of events which may never occur, such as the realization of depreciable property and goodwill, and also represents the retroactive taxation of gains accrued prior to 'valuation day'.

Senator Phillips (Rigaud): Would you be good enough to read into the record the bottom of page 7 with respect to your capital cost allowance problems which, after all, are related directly to your industry?

Mr. Draeseke: Yes.

> The "White Paper" implies that the existing capital cost allowance rates may be too generous and that the Government intends to invite briefs with respect to the subject. It is our opinion that the rates are generally satisfactory.
>
> The British Columbia forest industry already bears a greater tax load than most of its foreign competitors. Any further inroads into the cash flow of the corporations involved should be carefully considered before implementation of any change.

In explanation of that I might add that we have a situation in British Columbia where our effective tax rate is about 55.9 per cent, or 56 per cent in round figures. It is this high because the logging tax, which is really an income tax imposed by the province, is at the rate of 15 per cent, whereas the federal Government only recognizes a rate of 10 per cent. The difference of 5 per cent can neither be offset nor deducted.

Senator Phillips (Rigaud): So that in effect gives you a tax in excess of 55 per cent as is?

Mr. Draeseke: As we are now.

Senator Cook: With reference to the capital cost allowances, your example shows that your competitors in the U.S. have a more generous allowance than you now enjoy.

The Chairman: Yes, 33 against 30.

Mr. Draeseke: In that particular case these comparisons deal with different classes of equipment and I would not like to generalize on them.

The Chairman: Senator Phillips (Rigaud) asked you to read paragraph 7 into the record. The last sentence of the first paragraph reads:

> It is our opinion that the rates are generally satisfactory.

Maybe that is not exactly the wording you wish to use, because they could be generous and be satisfactory?

Mr. Draeseke: Yes. Naturally we would like them to be more generous.

The Chairman: Do you mean that they are adequate?

Mr. Draeseke: They are adequate, yes.

The Chairman: They are adequate, but not generous?

Mr. Draeseke: No, not generous.

The Chairman: Are there other aspects?

Mr. Draeseke: In section 8 we revert to the competitive position and the fact that our industry can double on a sustained yield basis and create a product that is pretty nearly all exported. We need very much a better accumulation of capital than we have now, not a worse one. We are coming back to the point we made at the beginning.

The Chairman: Then you should be stressing the treatment of small businesses.

Mr. Draeseke: Yes, we are. We definitely stress that. We should continue to help small businesses.

Senator Leonard: In your example of comparisons in capital cost differentials you start with $151,000 capital costs and $202,000 in British Columbia, a difference before you start to earn any money really on capital cost of $51,000.

Mr. Draeseke: That is right.

Senator Leonard: Is that practically all tariff?

Mr. Draeseke: Tariff, plus 10 per cent federal sales tax, on which I would like to comment. The White Paper as I understand it is largely based on the Carter Report. That report said they institute this integrated tax system to eliminate the 10 per cent sales tax, but that is lost at this point.

Senator Leonard: As far as the White Paper is concerned, you will still start with this difference in capital cost allowance?

Mr. Draeseke: Yes, that will not go down.

Senator Leonard: So you are still up against the problem of generating the capital sums required to put you in some kind of competitive position regardless of the continuing taxation feature?

Mr. Draeseke: That is correct.

Senator Leonard: Where are these capital funds now mostly generated? Are they coming from other countries, the United States presumably, or are they being generated by the business itself in Canada or raised through Canadian investors?

Mr. Draeseke: This type of investment to continually update productivity comes almost entirely out of retained earnings. In answer to your question with reference to the differential in capital costs, we have made a suggestion to the Government that this could be overcome by treating capital investments in the same manner as the purchase of raw materials. If raw materials are incorporated into a product that is exported there is a remission on the duty. We say that when buying productive equipment and exporting more than half the production the same rule should apply. This has not happened yet.

The Chairman: This is a problem apart from the White Paper.

Mr. Draeseke: It is nothing to do with the White Paper. All we say is that the White Paper will not help us; it will make it worse.

Senator Phillips (Rigaud): But you are not dealing with the crucial point, that if dividends are distributed within two and a half years in order to give the shareholders the benefit of the tax credit, in effect speaking of your interest tree, you are chopping off a branch of the tree and the taxpayer goes down with it because there are not the accumulated resources to carry on.

The Chairman: They may be in the position if they are doing some of their capital development on retained earnings.

Senator Phillips (Rigaud): The White Paper will force the distribution of what otherwise would be retained earnings.

Mr. Draeseke: This is correct.

The Chairman: Of course, the answer the White Paper makes is that if there is no other way of doing it, why issue rights? Obviously there is a limit to that.

Senator Phillips (Rigaud): There is a limit to that, because that goes to the question of the degree of savings and the economy at large and whether the money is available so that the right can be exercised.

The Chairman: That is right.

Senator Everett: On page 9, in the third paragraph you refer to section 631 of the United States Code. Can you tell me how that varies from the present law in Canada, whether the White Paper proposals change the present law in this regard?

Mr. Draeseke: No, the present law in the United States versus Canada is this. A company in Washington—Wirehauser is a good example—owns timber which it bought years ago at 50 cents a thousand. That same timber today has a value on the stump of $20 a thousand. They cut and process the timber. Under the U.S. law they say that in order to replace that timber at today's cost it would be $20; therefore the difference between 50 cents and $20 is treated as a capital gain and taxed at 25 per cent. Then the profit made in manufacture beyond that stumpage value is taxed at the normal rate.

Senator Everett: But there is a deduction based on the $20?

Mr. Draeseke: Yes, a deduction. In Canada the whole difference between 50 cents and what is realized is all taxable profit.

Senator Everett: There is a deduction of 50 cents.

Mr. Draeseke: We only get a deduction of 50 cents. The effect is that our companies are having an effective rate of 56 per cent. Our competitors in Washington and Oregon end up with an effective rate of about 30 per cent; it varies from about 28 to 36 per cent.

Senator Everett: It is the difference between cost and value?

Mr. Draeseke: That is right, on standing timber.

Senator Everett: And the capital gains tax is paid inbetween.

The Chairman: The capital gains tax will impinge on that.

Senator Everett: No, they propose to leave it at cost.

Senator Cook: I think paragraph (e) on page 11 sums it up very well.

Mr. Draeseke: There we say:

> Finally, the Council cannot support the radical change in taxation policy which is implicit in the tax reform package put forward in the "White Paper". The danger is too great that the effect on the Canadian economy would be severely damaging. The Government has not presented to the Canadian public reasonable proof of the economic effects nor justifications of the expected increase in revenue. The full economic effect of the proposal would only be known after the system has been in force for some time—when it could be too late to remedy the situation.
>
> It is better to live with, and improve, a system of which the economic effects are known than to be pioneers and potential losers in an unpredictable reform.

The Chairman: Does that cover your summary?

Mr. Draeseke: There is one other point I would like to make. I would like to draw your attention to paragraph (d) on page 11, which is perhaps a point not touched on yet, where we say:

> A prerequisite of many of the proposals is Provincial co-operation. The excessive burden imposed on our industry by the income tax payable under the B.C. Logging Tax Act without proper offset is an example of the lack of Federal-Provincial co-operation already in existence. Another is the considerable disparity between the Federal and B.C. succession duty statutes.

This is an added difficulty that we think is present in the White Paper.

The Chairman: The reason I asked if you were through is that I have a memorandum indicating that the following associations, in accordance with letters that have been

received by us from them, indicated their support and endorsement of the brief submitted by the Council of the Forest Industries of British Columbia, that is, Northern Interior Lumbermen's Association and Cariboo Lumber Manufacturers' Association. Who are they?

Mr. Draeseke: They represent the northern and central part of British Columbia respectively. They are the local groups of the logging, sawmill and plywood operators. They have had copies of our brief because they are affiliated members of our council.

The Chairman: I put it into the record so that we note their support.

Mr. Draeseke: Thank you.

The Chairman: Is there anything else you would like to add at this time?

Mr. Draeseke: May I just consult with my colleagues?

The Chairman: Yes.

Mr. Draeseke: I presume our brief is available to everybody.

The Chairman: Yes.

Mr. Draeseke: Then there is nothing more except what is in our brief.

The Chairman: I can tell you that your brief has been analyzed by Mr. Gilmour and each member of the committee has a copy of his analysis.

Mr. Draeseke: Thank you, Mr. Chairman.

The Chairman: We have the information, but I just want to be sure that you feel you have had the opportunity to say what you wanted.

Mr. Draeseke: I feel we have made our main points.

The Chairman: Some of the points in your brief were developed earlier today.

Mr. Draeseke: Yes, I was listening to them with some interest. We thank you very much for your hearing.

The Chairman: I want to thank you and your associates. It is part of our job to consider these things. Thank you very much.

The committee adjourned.

APPENDIX "A"

ANGLO AMERICAN CORPORATION OF CANADA LIMITED

Submission to the Standing Committee of the House of Commons on Finance, Trade and Economic Affairs

WHITE PAPER PROPOSALS FOR TAX REFORM

March 3, 1970

SUMMARY

The interests of Anglo American Corporation of Canada Limited are those of the investment arm in Canada of a large international mining and finance Group, with many opportunities for mineral investment abroad, which has invested substantially in Canada on a basis reflecting the current after-tax rates of return to mining companies.

We are gravely concerned about the impact of the White Paper proposals on the taxation of resource industries. Largely financed by non-resident investors, we are equally concerned about the impact of the White Paper on the non-resident investor, and particularly on the non-resident investor in the extractive industries.

Within the Group, we believe the adverse treatment of non-resident investors in the White Paper, if implemented without substantial modification, will be to concentrate the Group's attention on investment opportunities abroad; to reduce the continued expansion within Canada of our company; to defer indefinitely large scale Canadian investments currently under consideration; to divert elsewhere within the Group foreign investment opportunities for our company; and to force the repatriation of capital by associated Canadian companies.

In domestic terms, we believe there should continue to be a tax free flow of dividends as between Canadian companies. The artificial distinction between widely-held and closely-held companies should be abolished; incentives for small incorporated businesses can be accomplished by other means. The $2\frac{1}{2}$ year limitation on corporate distribution for creditable tax purposes is too short a period. The present proposals will force a major restructuring of our Canadian operations for tax and not for business reasons.

Equally, we oppose the differential treatment of capital gains on shares of widely-held and closely-held corporations; both should be treated alike. The proposed tax on unrealized gains should not be implemented. Consideration should be given to taxing capital gains at different rates, with long term gains being exempt, a separate rate for medium term gains and gains made within a relatively short time being taxed as ordinary income. The rate on medium term gains should be less than rates on ordinary income to encourage capital formation. The proposal to tax non-residents on gains realized and unrealized in Canada has no counterpart in any other major tax system. In the interest of continued non-resident investment in Canada, quite apart from the substantial difficulties in implementing the necessary tax treaty changes, such a tax should not form part of the new system.

To be truly effective, incentives offered the mineral industries should accrue ultimately as a net saving to the investor. Thus provincial mining taxes and earned depletion and accelerated depletion taken by a company in a year should be included as part of a company's creditable tax for dividend purposes. All capital costs for new and existing mines should be available for accelerated depreciation and earned depletion. The rate at which depletion is earned and the manner in which it can be deducted should be altered. The proposed incentives will not be attractive to non-resident investment capital.

International mobility of executive skills is important. The proposed tax treatment of Canadians posted abroad for temporary periods and of non-residents posted to Canada temporarily is inequitable.

Business reorganizations should be facilitated on liberal terms under the proposed system, and formal advance tax rulings should be available.

A. BACKGROUND

1. Our Company ("Amcan"), which directly and through several subsidiary companies, has net assets of the order of $120 million, holds the bulk of the Canadian investments of the largest mining finance group in the world. This Group, comprising Anglo American Corporation of South Africa, Limited, De Beers Consolidated Mines Limited and Charter Consolidated Limited, holds investments which at the end of 1968 were estimated to be worth $3,000 million. The Group's activities embrace gold, diamond, copper and coal mining and a wide range of industrial interests throughout the world. It is presently involved in geological exploration in five continents; Southern and Central Africa are the main areas of activity, but associated companies are engaged elsewhere in North and South America, Australia and the Far East.

2. Whilst Amcan is the principal investment arm of the Group in this country, other associated companies hold investments directly in Canada, including a substantial shareholding in Western Decalta Petroleum Limited.

3. The views expressed in this letter are those of the Group as a whole. Attached is Appendix "A" which shows diagramatically the corporate structure of the Group and the relationship of Amcan and its subsidiaries.

4. The Group's interests in Canada include the diversified investment portfolio of Amcan, and assets held directly by other associated companies. The following is a summary of the total assets of the Group in Canada as at December 31st, 1969:

AMCAN		
Natural Resources		
Hudson Bay Mining and Smelting Co., Limited	$ 68,328,000	
New Imperial Mines Ltd.	3,000,000	
Agnew Lake Mines Ltd.	2,700,000	
Other	13,285,000	
	87,313,000	
Transportation		
White Pass and Yukon Corporation Limited	12,003,000	
Land Development		
Great Northern Capital Corporation Limited	5,416,000	
Venture capital	1,557,000	
Other Canadian	492,000	
Total Canadian	106,781,000	
Foreign Investments	20,471,000	
Total AMCAN investments		127,252,000
INTERLINK		
Western Decalta Petroleum Limited	27,958,000	
Additional Canadian Investments	408,000	28,366,000
OTHER CANADIAN GROUP COMPANIES		
Additional Canadian Investments		6,322,000
		$ 161,940,000

5. You will note that our principal investment in Canada is a 28 per cent shareholding in Hudson Bay Mining and Smelting Co., Limited. This company will be submitting a

brief to you to illustrate the harsh effect of the White Paper proposals on a large integrated mining company.

6. Another important investment, although relatively small in value, is our controlling interest (with Hudson Bay Mining and Smelting Co., Limited) in Baffinland Iron Mines Limited, which owns an immense deposit, near the north end of Baffin Island, of iron ore superior in grade to that found anywhere in North America. This deposit sooner or later is certain to be of real economic significance for Canada as an unequalled opportunity for Arctic development and as a source of export sales. However, total expenditures in order to start up production, for construction and mining operations at the minimum feasible rate, will exceed $100 million.

7. Canadian companies of our Group are also involved in exploration activity inside and outside of Canada. For example, wholly-owned Canadian subsidiaries have spent over $2 million in Canada on exploration, most of this sum during the past three years; an additional $300,000 has been spent on exploration in Mexico as part of a programme embarked upon towards the end of 1968. These figures exclude the considerable sums expended by Hudson Bay Mining and Smelting Co., Limited and Western Decalta Petroleum Limited and the $2.8 million expenditure on the Baffinland iron ore project.

8. In short, the Group's interests in Canadian natural resources range from companies which are basically engaged in exploration (Western Decalta Petroleum Limited and Baffinland Iron Mines Limited); those in the development stage (Agnew Mines Ltd.) to those which are established producers (Hudson Bay Mining and Smelting Co., Limited and New Imperial Mines Ltd.)

9. Because of the size and diversity of Amcan's investment in the extractive industries in Canada we are gravely concerned about the impact of the White Paper proposals on the taxation of resources industries. Because our various interests have been largely financed by non-resident shareholders, we are equally concerned also about the impact of the White Paper proposals on the non-resident investor, and particularly on the non-resident inventor in the extractive industries.

10. Before dealing with the White Paper in detail we wish to refer to our policy and objectives in Canada.

11. Our long term objective is to reinvest surplus funds in Canada after a reasonable return to our shareholders. The present dividend policy of Amcan in fact only provides a return of about 2.9 per cent on the break-up value of the company's shares. Interlink Investments Limited, the wholly-owned subsidiary of Charter Consolidated Limited and a substantial shareholder of Amcan, has invested in Canada $22.2 million since 1962. To the end of its last fiscal year, its earned income during this period, ignoring capital gains on investments, was $3.45 million of which only $750,000 has been paid abroad. We believe the White Paper proposals will force the liquidation of Interlink which presently has net assets worth $40.2 million with the consequent loss to the Canadian economy of the retention of capital and earnings.

12. The policy of the Group has always been to invite public participation in countries in which investments are made and it has been our intention to follow this pattern in Canada under appropriate market conditions by issuing shares to the public and seeking a listing on Canadian stock exchanges. The White Paper proposals have interjected an extraneous element affecting Amcan's timing in this regard, dictated purely for tax conditions, and not related to the long term interests of Amcan or its shareholders.

13. In considering our reaction to the White Paper proposals it must be borne in mind that we were attracted to Canada as a place where our funds and skills could be profitably employed in the development of the economy, and because of the long established government policy which encouraged investment by overseas concerns. Since our prime interest throughout the world is in the extractive industries, in addition to the mineral potential and political stability of Canada, one of the most important factors affecting the investment decision was the tax treatment accorded the extractive industries, and the overall impact of Canadian taxation. The price that we paid for our initial investment in Hudson Bay Mining and Smelting Co., Limited and all our decisions to commit funds to our respective projects and interests have been based upon our projections of after-tax cash flows.

B. GENERAL

1. In evaluating the impact of the proposals on our Company we have had to deal in a few weeks with a statement of government intentions matured over several years,

expressed in the briefest terms, without the benefit of supporting data available to the Government, and without the benefit of supplementary papers explaining the proposals in detail. Our comments, therefore, must be subject to any details concerning the White Paper that might be published in the future.

2. We recognize the validity of some criticisms of the existing tax system expressed in the White Paper and agree with the stated objective of eliminating certain deficiencies.

3. The White Paper proposes a tax system for Canada that differs from the existing system in several major respects. It is also substantially different from that of other major industrial countries. We do not criticize this aspect of the White Paper, except to point out that as an importer of capital, Canada might be better served by a system which is familiar to the international financial community.

4. The White Paper makes it clear that the Government recognizes the importance of the extractive industry to Canada and that the industry requires incentives to encourage future development. We believe that future development will depend substantially upon foreign capital and that Canada will not be served by a system which blatantly discriminates against foreign investors or provides any disincentives to the flow of foreign capital to Canada, and in particular, to the extractive industry sector of the economy.

5. Our analysis of the proposed tax system and its effect upon our Company and the Group of which it is part has led us to the conclusion that the overall impact of Canadian taxation on the Company's non-resident shareholders would be such that:

(a) a considerable amount of the funds which are presently invested in Canada would be repatriated to the ultimate shareholders for reinvestment in other countries;

(b) the expansion we have in mind for our Group in Canada would not happen; mineral opportunities existing in other countries such as Australia would be more attractive to the Group than those existing in Canada;

(c) opportunities presently afforded Amcan to invest abroad would be directed elsewhere within the Group;

(d) the after-tax return on projects such as the Baffin Island iron ore deposits would be too low to justify the Group supporting Amcan in embarking upon such a high risk venture.

6. The major areas of our concern, which are elaborated upon hereafter, are:

(a) the effect of integration upon corporate structures; the tax advantages to non-residents in holding their investment through closely held companies, which may prevent participation by the Canadian public; and the inequitable tax treatment accorded different corporate structures;

(b) the rate and form of capital gains tax;

(c) the inadequacy of the incentives offered the extractive industry.

7. We have certain suggestions for improving the proposals. In many cases, because we do not have access to the details of the government's proposals and the supporting information available to the government, we find it difficult to offer a meaningful alternative. We are concerned that in order to eliminate what we consider to be disincentives to foreign investment, modifications will have to be made to the proposals of such magnitude as to alter the substance of much of the White Paper. We believe, however that the importance of the extractive industry and foreign investment to Canada is of such significance that if this result follows, the government should consider reviewing the present system of taxation with a view to eliminating its deficiencies and improving the entire system. We believe that this could be readily achieved by stages and that the objectives of the White Paper be met within the suitably modified framework of the existing system.

C. INTEGRATION

1. We are particularly concerned with the following aspects of the proposals:

(a) different tax treatment for closely-held and widely-held companies;

(b) that in order to pass creditable tax to shareholders profits must be distributed within 2½ years.

2. Our objection to these proposals is that they impose different tax burdens on corporate profits based upon a largely artificial distinction resulting from the corporate structure involved. In particular:

(a) an additional 12½ per cent tax would be imposed on profits flowing from a widely-held company to a closely-held company;

(b) the ostensible value of the incentives granted to the extractive industry is largely eliminated by providing that untaxed income, or income carrying no creditable taxes (in the case of the extractive industry arising from earned depletion and capital cost allowance incentives), is taxed on distribution to the shareholders.

3. These consequences would not apply if Canadian equity investments were held directly by non-residents, or if the Canadian public were excluded, as Appendix "B" indicates.

4. We believe dividends should flow tax free through a corporate chain of Canadian companies, with the right to pass along to individual resident shareholders a proportionate share of the creditable tax paid by companies lower down the chain, in cases where the holding company owns more than a 10 per cent interest in the shares of the company creating the creditable tax. We assume that if all companies are treated alike, the benefits of integration so far as individuals are concerned would be limited to the 50 per cent credit now proposed for a widely-held company.

5. We see no validity to limiting creditable tax to situations where profits can be distributed within 2½ years and thereby penalizing the many companies that for sound business reasons must reinvest their earnings. The suggested use of stock dividends, as an arbitrary way of avoiding the 2½ year limitation, ignores serious difficulties in determining dividend payments in terms of shares, the cost of restructuring corporate capital structures and the depressing effect on equity values. The elimination of taxable credits in respect of inter-corporate dividends, tax exempt entities, and non-residents, we think makes the impact on the general revenues of removing the 2½ year limitation not significant.

6. But the overall effect of these proposals on the taxation of corporate profits would force Amcan to reorganize its existing corporate structure and become a public company at what is perhaps an inopportune time having regard to the stage of development of the company and current market conditions. We do not believe that the tax system should dictate corporate structures contrary to those suggested by relevant financial and business reasons.

7. Moreover, it will force the elimination of closely-held Canadian companies such as Interlink Investments Limited, with the consequent repatriation of the capital pool it has accumulated. Foreign exchange control restrictions, to say nothing of the impact of the proposals, would probably prevent its reinvestment in Canada.

8. Appendix "B" also describes the similar effects of the proposals on the flow of credits for capital gains taxes and upon investments in controlled companies located in jurisdictions with which Canada has a tax treaty.

9. We suggest that the proposals be revised to ensure that:

(a) corporate profits flow freely through a chain of Canadian companies as is the case under the present system, so that the tax system has a neutral effect whatever the corporate structure may be;

(b) taxes paid by a corporation after the system becomes effective may be fully utilized by resident individual shareholders as a credit against their taxes;

(c) accordingly, consideration should be given to abolishing the artificial distinction between closely-held and widely-held companies. Incentives to small businesses can better be accomplished in other ways.

D. CAPITAL GAINS

1. We are particularly concerned with the following aspects of the proposals:

(a) The different treatment accorded gains in shares of "closely-held" and "widely-held" companies.

(b) The taxation every five years of unrealized gains in shares of widely-held companies.

(c) The taxing of recoveries of cost when value on Valuation Day is less than cost.

(d) The vagueness of the "roll-over" provisions dealing with gain on corporate reorganizations, where, in many instances, what are truly unrealized gains will be taxed.

(e) The proposal to tax non-residents on gains in shares of closely-held companies and on realized and unrealized gains on shareholdings in excess of 25 per cent in widely-held companies.

2. We have already pointed out that there should be no distinction for dividend purposes between widely-held and closely-held companies. Equally, we can see no logical reason for subjecting gains on sales of shares of either type of company to tax at different rates, and consider that many artificial situations will be developed to take advantage of the lower rate.

3. We think that recognition should be given to the importance of the accumulation of capital and that capital gains, particularly where these have accumulated over a long period of time, should be exempted. Short term gains, such as windfall stock profits, should be taxed at high rates.

4. The five year revaluation proposal could have a substantial adverse effect on Amcan in relation to its investment in Hudson Bay Mining and Smelting Co., Limited. During the past ten years the range in market price of that company's stock has varied between \$8½-\$24¾, as Appendix "C" indicates. The notional gain to Amcan under the proposal could, assuming a \$24¾ range, vary between \$0 and \$20.88 million. The inequity of this proposal arises from the fact that the market value of such a permanent investment may at any given time bear no relation to the intrinsic value, particularly where a substantial number of shares are involved. We understand the Government is presently reviewing this proposal.

5. We think it is inequitable that the Government proposes to tax as a "gain" a recovery of cost, in cases where value at Valuation Day is less than original cost. Again the reduction in value below cost may be accounted for by factors having no bearing on the intrinsic value of the investment.

6. The importance of business reorganizations is such that we can only regret the limited treatment afforded this topic in the White Paper. Obviously detailed rules will be required, which should be cast in liberal terms, and with respect to which the business community will wish to make representations.

7. The proposals regarding the taxation of gains by non-residents will have a detrimental effect on investment by non-residents, particularly residents of countries which have no capital gains tax or which provide no credit for foreign taxes, or if the Canadian tax imposed exceeds the rate of tax abroad. The aspect of the proposals referred to has no counterpart in other major tax systems. We doubt that the Canadian government will be able to renegotiate treaties which will effectively avoid the double taxation of capital gains. For these reasons we are opposed to taxing non-residents on Canadian gains.

8. We suggest the proposals be revised to ensure that:

(a) No distinction is made between gains in sales of shares of closely-held companies and widely-held companies.

(b) Capital gains are taxed at a lower rate than ordinary income; consideration be given to exempting gains on long term investments or taxing them at low rates, with a higher rate on medium term gains and gains made within a short period of time being treated as ordinary income.

(c) The proposal to tax unrealized gains is eliminated.

(d) Gains are based on the difference between the market value and the higher of the value on Valuation Day or cost.

(e) The proposal to tax non-residents on capital gains is eliminated.

E. EXTRACTIVE INDUSTRIES

1. We are particularly concerned with the following aspects of the proposals:

(a) The increased burden of the combined provincial and federal taxes on the extractive industry.

(b) The reduced value of the incentives granted to the extractive industry as a result of integration.

(c) The lack of assurance that capital will be fully recovered before taxation.

(d) The restriction of the "earned depletion" allowance to capital expenditures relating to new mines but not to the expansion of existing mines.

(e) The inequities of the transitional provisions restricting the depletion allowance to properties owned at the time of the publication of the White Paper.

(f) The general inadequacy of the incentives to encourage the further development of Canada's mineral resources.

2. The proposals ignore the burden on the mining industry of provincial taxes. Unless a credit is granted for provincial taxes the extractive industry will be subject to a tax burden in excess of that imposed on industrial companies.

3. Because of the negative effect of integration on the value of the incentives and the impact of provincial taxes, it is unlikely that the accelerated write-off and earned depletion provisions will in fact provide an incentive to the extractive industry as compared with other industries. At best the incentives provide tax deferment and not a net saving to the investor, since they create no creditable tax the benefits of which will accrue to shareholders upon distribution. The reduced value of the incentives is further magnified by the restriction of the earned depletion provisions to capital expenditures on new mines. The relative effect is to provide an incentive to develop a new mine which might be a comparatively inefficient operation, rather than expand an existing mine, solely for the tax benefits. There is often a substantial benefit to be obtained from expansion of existing mines as compared with the development of new marginal property.

4. The proposals restrict the percentage depletion allowance to properties owned at the time of the publication of the White Paper. As a result, transfers of producing mining properties would be discouraged during the five year transitional period. If properties are transferred in these circumstances during that period they will lose the current depletion allowance. We do not think that this result is in any way justified.

5. The proposal to tax the gain on the disposal of mineral properties would discourage the transfer of the properties and impede the development of the properties.

6. The proposals perpetuate, perhaps unintentionally, one of the defects of the existing system. A company which spends more than one-half of its profits before eligible expenditures are deducted, is denied a deduction in that year of all the depletion it has "earned". And the more it spends on exploration, the smaller the percentage of its earned depletion expenditures are available to it in a particular year. A company with a constantly expanding exploration programme may never make use of all its earned depletion.

7. There does not appear to be any rational basis for selecting a ratio of depletion of $1 for every $3 of eligible expenditures incurred. We believe that the overall treatment of the extractive industry proposed in the White Paper will not provide a sufficient incentive to encourage the continued development of Canada's natural resources at the rate currently enjoyed. The existing system of percentage depletion has provided the necessary stimulus to resource development, and consideration could be given to a continuation of this system at a somewhat lower rate. We therefore believe that the method employed should, when considered with the other suggestions that we make below, be geared to providing sufficient encouragement to the development of our resources.

8. The proposals regarding depletion treat the mining and petroleum industries on an equal basis. But the proposals are more attractive to the petroleum industry, because more of the expenditures involved in bringing a well into production will be eligible expenditures than in the case of a mining property. Compared with the development of an oil field, the development of a mine involves substantial capital expenditures developing townsites, schools, railroads, and certain plant facilities to bring a mine into production. Under the proposals none of these expenditures would qualify for earned depletion nor would most of them be available for accelerated depreciation. Only $48.4 million of our Baffinland project expenditures would qualify for accelerated depreciation and earned depletion; this represents just under 50 per cent of the investment required.

9. It is not possible to tell whether offshore exploration expenses will be considered to fall into the class of "nothings" to be written off at the rate of 20 per cent a year. In our view, these expenditures should logically be included in this class.

10. Equally the effect of the proposals on income bonds, a traditional form of mining finance, is unclear. We assume that interest payments on such bonds will be considered as dividends entitled to creditable tax on the same basis as preferred shares.

11. We suggest that the proposals be revised to ensure that:

(a) Provincial mining taxes, which are really income taxes, be a credit against a mine's federal income taxes. We recognize this will entail federal-provincial agreement.

(b) The creditable tax base of a mining company should include both federal income taxes and provincial mining taxes.

(c) Effective incentives should accrue to the investor, and accordingly, an investor should be entitled to receive, in effect tax free, an amount equal to his proportionate share of the earned depletion and

accelerated capital cost allowances taken by the Company in computing its taxable income for the year.

(d) In order to ensure that (i) all capital expenditures which are necessary to bring a mine into production are recovered before taxation; and (ii) the development and improvement of existing mines receive comparable incentives to those offered new mines, accelerated depreciation and the eligible expenditures for the earned depletion allowance should be expanded to include development work after production commences, the extension of existing mine assets and other capital costs such as roads, harbour facilities and refineries.

(e) The adequacy of the incentives be reviewed by the Government and consideration be given to providing a depletion allowance on a more favourable basis than $1 for every 3 of eligible expenditure incurred. The maximum allowance for "Earned Depletion" should be based on corporate profit before deducting "eligible expenditures".

(f) Provisions be made to ensure that a gain on the disposal of a mineral property will not be recognized until the shares or other assets received in exchange are sold.

(g) Transitional provisions ensure that the properties acquired by the taxpayer after publication of the White Paper be entitled to percentage depletion.

F. TEMPORARY RESIDENCE ABROAD AND IN CANADA

1. Mobility of skilled technical personnel within our Group is vital to its proper functions in Canada and elsewhere. We think that there should be no tax disincentives to inhibit transfer on a temporary basis.

2. We suggest the proposals be revised to ensure that:

(a) Canadian residents transferred in the course of employment for a temporary period should be entitled to continue to file returns as a resident.

(b) Following the lines of the current legislation in the United Kingdom, non-resident executives transferred to Canada for a temporary period should be taxed by Canada only on employment income received in Canada, gains realized in Canada and not on gains realized abroad, unless the proceeds are remitted to Canada.

G. ADVANCE RULINGS

The White Paper made almost no reference to the administration of the new Act. We think that there should be, along the lines of the American legislation, a system of advance tax rulings available to taxpayers so that the tax consequences of business mergers and amalgamations can be accurately predicted in advance.

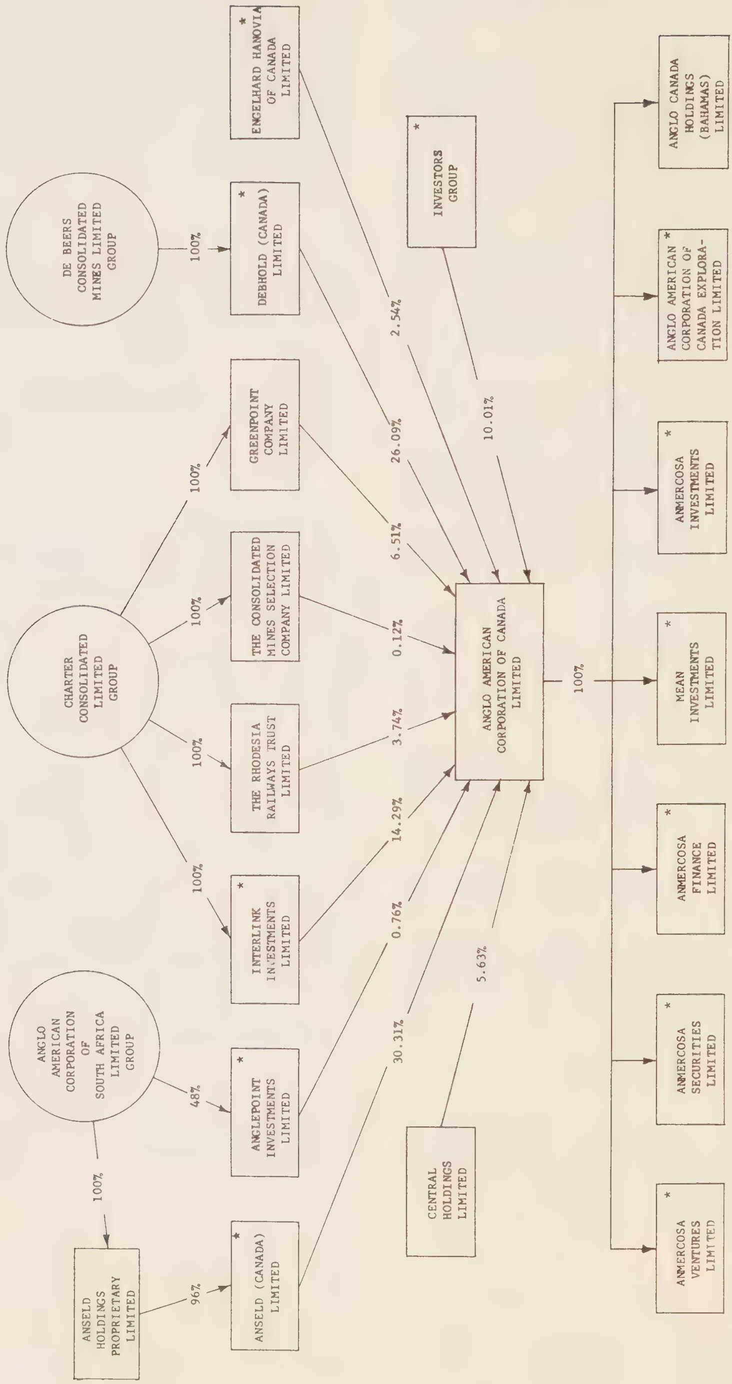
H. CONCLUSION

It is our belief, and we think it is a generally held opinion, that continued encouragement of the extractive industries is necessary if the development of Canada's mineral resources is to continue at its present rate. This surely requires more capital than is presently available in Canada. Such development is in the best interests of those large and remote areas of the country, such as Baffin Island, where economic and social progress appears to depend upon mineral development, and it would be difficult to overstate the relative importance of the extractive industries in the economy of Canada. Canada must compete for external capital for these purposes, which so far as risk capital of the sort our Group has supplied is concerned, is generally available only for the extractive industries; therefore, Canada should seek to ensure that its competitive position remains a good one.

We believe that implementation of the White Paper proposals will result in a less attractive climate for foreign investment in the extractive industries, and will materially and adversely affect the Canadian economy as a whole.

APPENDIX "A"

GROUP STRUCTURE



* Denotes company incorporated in Canada.

APPENDIX "B"

1. Effect of Integration Proposals on Dividends

(a) Table 1

Present System

Column 1—Shows dividend flow through the Canadian Group to a non-resident shareholder.

Column 2—Shows dividend on shares held directly by non-resident shareholder.

White Paper

Column 3—Shows dividend through Canadian Group to non-resident shareholder, assuming AMCAN has become widely-held.

Column 4—Shows the same effect as Column 3 except that it is assumed that Anmercosa elects the partnership option.

Column 5—Shows dividend through to AMCAN (widely-held) and directly to non-resident shareholder, assuming INTERLINK has been liquidated.

Column 6—Shows the same effect as Column 5 except that it is assumed that Anmercosa elects the partnership option.

Column 7—Shows dividend from HUDSON BAY MINING directly to non-resident shareholder.

(b) Comments

It will be noted from Table 1 that as long as a CHC is interposed between a non-resident shareholder and a WHC an additional tax of 12½% would be imposed under the proposals (See columns 3-5). In the Group's case, depending on whether Anmercosa elected the partnership option or not, the incidence of this tax would fall on either Anmercosa or Interlink. In order to eliminate this result and to obtain a tax treatment comparable to that available under the present system or when a WHC is held by a non-resident (as is illustrated in column 7) it would be necessary to eliminate Interlink and convert Amcan into a WHC, the effect of which is illustrated in column 6.

The effect of eliminating Interlink from the Group's Canadian corporate structure would be to repatriate earnings directly to the non-resident shareholders. Because of sterling foreign exchange control restrictions, it is unlikely that these earnings would be reinvested in Canada.

TABLE I

Comparison of Tax Effect of Present and Proposed Tax Systems on the Dividend Flow from Hudson Bay Mining to Non-Resident Shareholders

	Present System		White Paper				
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Hudson Bay Mining (*WHC*)							
Dividend paid	100.00	100.00	100.00	100.00	100.00	100.00	100.00
(Corporate tax assumed to be $25.00)							
Anmercosa Investments (*CHC*)							
Dividend	100.00		100.00	100.00	100.00	100.00	
Gross up			12.50		12.50		
			112.50		112.50		
Tax @ 50%			56.25		56.25		
Less creditable tax			12.50		12.50		
Tax payable			43.75		43.75		
Available for dividend	100.00		56.25	100.00	56.25	100.00	
Amcan (*WHC*)							
Dividend	100.00		56.25	100.00	56.25	100.00	
Gross up			56.25	12.50	56.25	12.50	
			112.50	112.50	112.50	112.50	
Tax @ 50%			56.25	37.50	56.25	37.50	
Less creditable tax			56.25	12.50	56.25	12.50	
Tax payable			Nil	25.00	Nil	25.00	
Available for dividend	100.00		56.25	75.00	56.25	75.00	
Interlink (*CHC*)							
Dividend	100.00		56.25	75.00			
Gross up			28.12	18.75			
			84.37	93.75			
Tax @ 50%			42.18	46.88			
Less creditable tax			28.12	18.75			
Tax payable			14.06	28.12			
Available for dividend	100.00		42.19	46.87			
(N.R.) Dividend	100.00	100.00	42.19	46.87	56.25	75.00	100.00
Withholding tax 15%	15.00	15.00	6.33	7.03	8.44	11.25	15.00
Net receipt	85.00	85.00	35.86	39.84	47.81	63.75	85.00

2. Effect of Integration Proposals on Capital Gains Tax Credits

(a) Table 2

Column 1—Shows a capital gain flowing from Hudson Bay Mining through Amcan, assuming Amcan is a CHC.

Column 2—Shows a capital gain flowing from Hudson Bay Mining through Amcan, assuming Amcan is a WHC.

(b) Comments

Table 2 illustrates the effect of the proposals on the flow of credits for capital gains taxes. Again it can be seen that as long as a CHC is interposed between a WHC and foreign shareholders, an additional tax is imposed.

A similar effect would result on the flow of a dividend from a controlled foreign company through a chain of Canadian companies and eventually to a non-resident shareholder.

TABLE 2

Illustration of the Tax Effect of the Proposals on the Flow of Credits for Capital Gains Tax through Different Corporate Structures

Hudson Bay Mining (WHC)	(1)	(2)
Gain from sale of WHC share	100.00	100.00
Tax @ 33⅓%	33.33	33.33
Available for dividend	66.67	66.67
Amcan		
Dividend	66.67	66.67
Gross up	33.33	33.33
	100.00	100.00
Tax @ 50% *@ 33⅓%	50.00	*33.33
Less creditable tax	33.33	33.33
Tax payable	16.67	Nil
Available for Dividend to Non-Resident	50.00	66.67

APPENDIX "C"

Hudson Bay Mining and Smelting Co., Limited

Ten-year range of closing prices on The Toronto Stock Exchange

Year	High	Low	Difference between high and low
	$	$	$
1960	52	43	9–
1961	57¾	45	12¾
1962	59¼	46	13¼
1963	59¼	50¾	8½
1964	75⅞	57¼	18⅝
1965	80	65	15
1966	87	62¼	24¾
1967	70¼	54½	15¾
1968	76¼	53¾	22½
1969	89¾	71¾	18–

APPENDIX "B"

ANGLO AMERICAN CORPORATION OF CANADA LIMITED

Foreign Investment in the Canadian Mining Industry

March 19, 1970

Analysis of Appendix "A" by Senior Advisor

This is a comprehensive brief submitted by an international mining finance group whose total assets are estimated to be worth $3,000 million.

The investment of this group in Canadian assets at December 31, 1969 was $161.9 million.

The brief refers to the following subjects:

(A) Grossing-up of Canadian dividends:
- (i) Closely-Held and Widely-Held Corporations.
- (ii) Distribution of dividends in 2½ year period.

(B) Capital Gains:
- (i) Closely-Held and Widely-Held Corporations.
- (ii) Five Year Revaluation of Shares.
- (iii) Value of Assets and Cost of Assets.
- (iv) Business Reorganizations.
- (v) Taxation of Non-Residents.

(C) The Canadian Mining Industry Generally:
- (i) Provincial Mining Taxes.
- (ii) Earned Depletion
- (iii) Purchase or Sale of Mining Leases or Properties.
- (iv) Offshore Exploration Expenses.
- (v) Income Bonds

(D) Temporary Residence beyond Canada

(E) Advance Rulings by Taxation Division of the Department of National Revenue.

Members of the Committee may be interested in the following conclusions drawn from the brief:

(1) "The White Paper proposes a tax system for Canada that differs from the existing system in several major respects. It is also substantially different from that of other major industrial countries. We do not criticize this aspect of the White Paper, except to point out that as an importer of capital, Canada might be better served by a system which is familiar to the international financial community."

(2) "Our analysis of the proposed tax system and its effect upon our Company and the Group of which it is part has led us to the conclusion that the overall impact of Canadian taxation on the Company's non-resident shareholders would be such that:

(a) a considerable amount of the funds which are presently invested in Canada would be repatriated to the ultimate shareholders for reinvestment in other countries;

(b) the expansion we have in mind for our Group in Canada would not happen; mineral opportunities existing in other countries such as Australia would be more attractive to the Group than those existing in Canada;

(c) opportunities presently afforded Amcan to invest abroad would be directed elsewhere within the Group;

(d) the after-tax return on projects such as the Baffin Island iron ore deposits would be too low to justify the Group supporting Amcan in embarking upon such a high risk venture."

(3) "We have certain suggestions for improving the proposals. In many cases, because we do not have access to the details of the government's proposals and the supporting information available to the government, we find it difficult to offer a meaningful alternative. We are concerned that in order to eliminate what we consider to be disincentives to foreign investment, modifications will have to be made to the proposals of such magnitude as to alter the substance of much of the White Paper. We believe, however that the importance of the extractive industry and foreign investment to Canada is of such significance that if this result follows, the government should consider reviewing the pre-

sent system of taxation with a view to eliminating its deficiencies and improving the entire system. We believe that this could be readily achieved by stages and that the objectives of the White Paper be met within the suitably modified framework of the existing system."

There is attached the usual summary of existing tax laws, White Paper proposals and principal points of the Brief.

Name: Anglo American Corporation of Canada Limited

Principal Subject: Grossing-Up of Canadian Dividends

(A) Closely-Held and Widely-Held Corporations

Present Tax Law

Under the present Income Tax Act:

(a) Corporations pay annual income taxes of a lesser amount on the first $35,000 of taxable income and of a larger amount on taxable income in excess of $35,000.

(b) Dividends generally flow free of tax between Canadian companies.

(c) Canadian shareholders who are individuals pay income tax on dividends received and deduct 20% of Canadian dividends received from the income taxes payable by them.

(d) Non-resident shareholders pay a 10% or 15% Canadian tax on dividends received.

Tax Reform Proposals

The proposals of the White Paper respecting the grossing-up of Canadian dividends are dealt with in Special Study No. 4 and are not repeated here.

Principal Points of Brief

Page 11, paragraphs (1) and (2) of Brief

This portion of the brief criticizes the difference in the grossing-up procedures suggested for shareholders of widely-held and closely-held corporations.

Page 11, paragraph (3) of Brief

This part of the brief points out that the harmful effect of the proposed grossing-up procedures can be eliminated if:

(a) Canadian equity investments are held directly by non-residents, or if the

(b) Canadian public is excluded from being shareholders of Canadian companies.

Page 12, Paragraph (4) of Brief

This part of the brief recommends that dividends continue to flow free of tax from one Canadian company to another.

Page 12, paragraphs (6), (7) and (8) of Brief

These paragraphs point out the withdrawal of capital from Canada that may result if the grossing-up procedures are adopted.

Page 13, paragraph (9) of Brief

This portion of the brief recommends that:

(a) dividends be permitted to flow free of tax between Canadian companies;

(b) the distinction between widely-held and closely-held corporations be abolished, and

(c) incentives to small businesses be accomplished in other ways.

(B) Distribution of Dividends in 2½ Year Period

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
There is no reference to this subject in the present Income Tax Act.	See Special Study No. 4.	Page 12, paragraph (5) of Brief This portion of the brief comments on the proposal to require corporations to distribute earnings within 2½ years of being earned.

Principal Subject: Capital Gains

(A) Distinction Between Closely-Held and Widely-Held Corporations

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
There is nothing in the present Income Tax Act which imposes an income tax on capital gains.	3.31 The definition of a closely-held Canadian corporation is given in Chapter 4, but it would include most Canadian private corporations. Gains on the sale of shares of these corporations would be fully taxed, and losses on the sale of such shares would be fully deductible (subject to protection against	Page 15, paragraph (2) of Brief This portion of brief points out that there is no reason for the distinction in taxation of gains realized on the sale of shares of closely-held corporations (100%

Name: Anglo American Corporation of Canada Limited

Principal Subject: Capital Gains

(A) Distinction Between Closely-Held and Widely-Held Corporations

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	the deduction of personal expenses). This treatment, when coupled with the credit given to Canadian shareholders for the Canadian corporate tax paid by these companies, (see Chapter 4) would produce a balanced system in which there is little if any tax advantage to be secured by a taxpayer through receiving his share of the income of the corporation in the form of gains on the sale of shares rather than dividends, or vice versa. This would remove one of the strongest temptations to tax avoidance in the present act. It would also produce a system in which the weight of tax on private companies is identical to that on the unincorporated businesses with which they compete. This balance is explained more fully in Chapter 4.	taxable) and widely-held corporation (50% taxable). Page 17, paragraph (8a) of Brief This portion of brief suggests the elimination of the difference in taxation on gains realized on the sale of closely-held and widely-held corporations. Page 15, paragraph (3) of Brief This part of the Brief suggests a more equitable system might be to exempt long term gains from any tax but tax short term gains at high rates.
	3.33 Taxpayers other than widely-held Canadian corporations would include only one-half of their gains on the sale of these shares in taxable income and deduct only one-half of their losses. However, they would be required to revalue these shares to market value every five years and take one-half of the resulting gain or loss into account for tax purposes in that year. A special rate is proposed for widely-held Canadian corporations to avoid double tax. This is explained in Chapter 4.	Page 17, paragraph (8b) of Brief This part of the brief recommends difference in taxation of short gains and long term gains.
	3.34 The rule that only one-half of gains or losses would be taken into account for tax purposes would put Canadians in approximately the same tax position regarding capital gains and losses on these shares as most of the non-residents who invest in Canada. Specifically, it would put them on approximately the same footing as American indi-	

viduals and corporations and British individuals and corporations. (It would be impracticable to attempt to tax non-residents on their profits on the sale of small blocks of publicly listed Canadian shares.)

3.35 The 50-per-cent taxability of such gains, coupled with the 50-per-cent credit for corporate tax paid by such corporations, should also result in a relatively balanced system in which there is little incentive for Canadians to receive their income in the form of capital gains rather than dividends, or vice versa. Again this balance is explained more fully in Chapter 4.

(B) Five Year Revaluation of Shares in Widely-Held Corporations

Present Tax Law

There is no reference to this subject in the present Income Tax Act.

3.17 Once the tax on capital gains had been part of the system for a few years, taxpayers would begin to report gains that had accrued over several years. In the absence of special provisions, this could result in a much larger than usual income in that year and could make the taxpayer liable for a marginal rate of tax considerably higher than the rates that would have applied had his income been spread over the years during which the gain accrued. The averaging provisions described in Chapter 2 would overcome this effect.

3.33 Taxpayers other than widely-held Canadian corporations would include only one-half of their gains on the sale of these shares in taxable income and deduct only one-half of their losses. However, they would be required to revalue these shares to market value every five years and take one-half of the resulting gain or loss into account for tax purposes in that year. A special rate is proposed for

Principal Points of Brief

Page 16, paragraph (4) of Brief

This portion of the brief points out the adverse effect of this proposal on an investment of the company.

Page 18, paragraph (c) of Brief

This part of the brief recommends the elimination of the proposal to tax unrealized capital gains.

Name: Anglo American Corporation of Canada Limited

Principal Subject: Capital Gains

(B) Five Year Revaluation of Shares in Widely-Held Corporations (Continued)

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	widely-held Canadian corporations to avoid double tax. This is explained in Chapter 4. 3.34 The rule that only one-half of gains or losses would be taken into account for tax purposes would put Canadians in approximately the same tax position regarding capital gains and losses on these shares as most of the non-residents who invest in Canada. Specifically, it would put them on approximately the same footing as American individuals and corporations and British individuals and corporations. (It would be impracticable to attempt to tax non-residents on their profits on the sale of small blocks of publicly listed Canadian shares.) 3.35 The 50-per-cent taxability of such gains, coupled with the 50-per-cent credit for corporate tax paid by such corporations, should also result in a relatively balanced system in which there is little incentive for Canadians to receive their income in the form of capital gains rather than dividends, or vice versa. Again this balance is explained more fully in Chapter 4. 3.36 The proposal that the accrued gains or losses on those shares be taken into account every five years is one of two exceptions to the general rule that capital gains and losses would be taxable only when they are realized. (The other exception concerns taxpayers who leave Canada.) Periodic revaluation would reduce somewhat the value of the half-gains rule. It would reflect the fact that these shares are readily marketable and that a taxpayer can, therefore, realize his gain or loss fairly easily	

at the time of his choosing. The shares of private companies do not have the same marketability.

3.37 Periodic revaluation would also reduce the "lock-in" effect that might well otherwise occur. If a taxpayer faces a tax on the sale of an investment, and that tax is postponed if he holds on to the investment, he may feel "locked in". As long as he holds, he would have, say, $100 working for him. If he sells, he would have only, say, $90 or $95 to reinvest. Since periodic revaluation would reduce this lock-in effect, it would reduce what might otherwise be an obstacle to the workings of the capital market. Revaluation would also make it feasible for the government to classify more corporate reorganizations and mergers as tax-free transactions than would otherwise be the case, thus removing a tax barrier that might otherwise have impeded transactions that are desirable for economic reasons. Finally, it would reduce the tax postponement which would otherwise result from the treatment suggested in paragraph 3.42 to those cases where the lack of marketability of the assets made the treatment compelling.

3.38 The process would not begin until five years after capital gains become taxable. Beginning in the fifth year, individual taxpayers would revalue their holdings of shares of widely-held Canadian corporations in each year in which they attain an age that is divisible by five. Corporations would also revalue their holdings of these shares every five years, likely on the fifth anniversary of incorporation and each other anniversary divisible by five. Dispersing the valuation process through a five-year cycle would reduce the pressure in any particular year—the pressure of the work load on the administration and the pressure that might otherwise develop on market prices every five years. To further disperse this latter pressure, it is proposed that revaluation take place as of the end of the month in which the significant birthday or anniversary takes place.

Name: Anglo American Corporation of Canada Limited

Principal Subject: Capital Gains

(C) Value of Assets and Cost of Assets

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
There is no reference to this subject in the present Income Tax Act.	3.15 The government does not propose to tax gains that arise before the new system is introduced unless those gains would have been taxed under the present system. Consequently, the general rule would be that taxpayers could deduct from the proceeds of sale of assets the value of those assets on "valuation day". Consider the case of the taxpayer who bought a block of shares in 1964 for $1,500 which today is worth $2,500. If the new system were to go into effect with today as valuation day, and if the taxpayer were to sell his shares a year from now for $2,600, his taxable gain would be only $100. If he were to sell them for $2,100, he would have a loss for tax purposes of $400. 3.16 The natural and ordinary thing to do would be to proclaim that valuation day is to be the day on which the new system is to begin. However, if that were done, the pressure on market prices on that day could be tremendous, and the opportunities for price-fixing too great. To avoid these consequences, the government proposes to choose a day close to the beginning of the system and to announce that evening that it was valuation day. 3.28 This category would involve investments such as bonds, mortgages, agreements for sale, and rental real estate. It is proposed that profits from the sale of these assets be brought fully into taxable income and that losses on the sale of assets of this type be fully deductible in computing taxable income. Taxpayers who obtain bonds, mortgages and agreements for sale at a discount with a low	Page 16, paragraph (5) of Brief This part of the brief suggests that cost should be substituted for value in those cases where the cost of an asset exceeds the value at Valuation Day. Page 18, paragraph (8d) of Brief This part of the brief recommends the above change.

coupon yield would be in the same position as taxpayers who buy at par with a higher coupon yield.

3.29 The general rule that taxpayers would not be taxed on more than the increase in value of such investments after valuation day would apply to these assets. Further, if bonds, mortgages and agreements for sale that a taxpayer now holds are worth less on valuation day than the taxpayer's cost—or his "amortized" cost if he bought it at a discount—the recovery of cost or amortized cost would not be treated as income. For example, if a taxpayer bought a 6-per-cent bond at $100, and that bond is quoted on the market on valuation day at $85, there would not be tax on the redemption or sale of the bond unless the taxpayer receives more than $100. Another taxpayer who purchased a bond of that issue in the market for $80 would be taxed on redemption or sale if he receives more than the $85, unless writing the $20 discount off over the remaining term of the bond would have increased his "amortized cost" to more than $85.

3.30 The government does not wish to force Canadians to compute the "amortized cost" of their present portfolio of bonds where the original discounts were small. Therefore, if a taxpayer had purchased an issue for 95 per cent or more of its face value, he would be exempt from tax on sale or redemption, unless the proceeds exceed the face value of the bond. These transitional arrangements would, of course, only apply to taxpayers who are not at present taxable on the realization of discounts. Bond traders, chartered banks, life insurance companies and others who are now taxable on the realization of discounts would continue to be so.

Name: Anglo American Corporation of Canada Limited

Principal Subject: Capital Gains
(D) Business Reorganizations

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
There is no reference to this subject in the present Income Tax Act.	3.50 If a corporation splits its shares without increasing its paid-up capital, it would be a tax-free transaction and each shareholder would spread the cost to him of the old shares over the larger number of new shares. If, however, the corporation includes something else in the transaction—for example, in a reorganization involving common shares it includes debt claims or shares that are not common shares—it is proposed that shareholders be treated as having realized their potential capital gain to the extent of the value of this other asset that they have received. Also, if rights are varied in the reorganization—some shareholders receiving one thing and other shareholders of the same class receiving something else—it is proposed that it be a taxable transaction. 3.51 Most other reorganizations or mergers involve a change in economic interest—a barter. It is proposed that, at least initially, these transactions be treated as taxable realizations if they involve closely-held Canadian corporations or foreign corporations. It may still be possible later to identify more situations in which a rollover can be granted without permitting taxpayers to accomplish tax-free in an indirect manner what would be taxable if done directly.	Page 16, paragraph (6) of Brief This portion of the brief draws attention to the lack of explanation in the White Paper relating to business reorganizations.

(E) Taxation of Non-Residents

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	3.34 The rule that only one-half of gains or losses would be taken into account for tax purposes would put Canadians in approximately the same tax position regarding capital gains and losses on these shares as most of the non-residents who invest in Canada. Specifically, it would put them on approximately the same footing as American indi-	Page 17, paragraph (7) of Brief This portion of the brief explains the company's opposition to the proposals that capital gains realized by non-resident on Canadian assets be subjected to Canadian tax.

viduals and corporations and British individuals and corporations. (It would be impracticable to attempt to tax non-residents on their profits on the sale of small blocks of publicly listed Canadian shares.)

3.35 The 50-per-cent taxability of such gains, coupled with the 50-per-cent credit for corporate tax paid by such corporations, should also result in a relatively balanced system in which there is little incentive for Canadians to receive their income in the form of capital gains rather than dividends, or vice versa. Again this balance is explained more fully in Chapter 4.

6.44 Given the ease with which a gain on the sale of other assets can be transformed into a gain on the sale of shares of a corporation, it would also be necessary to tax certain gains by non-residents on the sale of Canadian shares. This need is strongly reinforced as regards closely-held Canadian corporations by the implications of the regime suggested for Canadian shareholders of those corporations. Since a Canadian can obtain full credit for the Canadian corporate tax paid by the corporation, and can deduct the full cost of his shares from his income when he sells those shares, he can afford to pay the full value of the corporation's assets (including creditable tax as an asset) when he buys the shares of the corporation.

6.46 This is the appropriate result provided the vendor is taxable on his capital gain on the sale of the share. He and/or the owners before him would have paid tax on the full $60,000 on the sale of their shares. Canada would have collected one tax—and only one—on the $60,000. But the vendor must be taxable, or the $60,000 would escape tax. Therefore it is proposed that non-residents as well as residents be taxed on their gains on the sale of shares of closely-held Canadian corporations. This would be buttressed by a "back-up" provision to place a responsibility on the purchaser to ensure compliance. A system of "certificates of

Page 18, paragraph 8(e) of Brief

This part of the brief recommends the elimination of the proposal to tax non-residents on Canadian capital gains.

Name: Anglo American Corporation of Canada Limited

Principal Subject: Capital Gains

(E) Taxation of Non-Residents (Continued)

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	compliance" would be necessary for private company share transfers—an awkward but necessary evil. 6.47 The same implications do not apply in the case of widely-held Canadian corporations. Canadian shareholders would receive credit for only half of the corporate tax paid and would be entitled to deduct only half of their loss on the sale of their shares. Also, it would be impracticable to attempt to tax non-residents on their sales of small lots of these shares. Therefore it is proposed that only those non-residents who are selling shares out of a substantial interest (25 per cent or more) would be taxable in Canada.	

Principal Subject: The Mining Industry Generally

(A) Provincial mining Taxes

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 11-1-p of the Income Tax Act This section of the Act permits taxes on the income from mining operations paid to a Canadian province or municipality to be deducted from the income on which the annual federal tax is computed. It may also be observed that the provincial income tax acts of Ontario and Quebec allow the provincial mining taxes as a deduction from income. Other provincial income tax acts, being based on the federal act, also grant a similar deduction from income.	The White Paper contains no proposals respecting provincial mining taxes, so it must be assumed that the existing tax legislation is considered satisfactory.	Page 26, paragraph (2) of Brief This portion of brief states that the mining industry is subjected to heavier taxation than industry generally because of the burden of provincial mining taxes. Page 26, paragraph (11) of Brief This portion of brief recommends (a) that provincial mining taxes be allowed as a deduction from federal income taxes, and (b) that the dividend tax credit allowed to shareholders be based on provincial mining taxes and federal income taxes.

(B) Earned Depletion

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 11-1-b of the Income Tax Act and Part XII of the Income Tax Regulations These sections state that a taxpayer who operates a mineral deposit or an oil or gas well is entitled to a depletion allowance of $33\frac{1}{3}\%$ of the profits attributable to such operation.	The proposals of the White Paper respecting the existing three-year tax holiday and percentage depletion are contained in the following paragraphs: 1.50 The government has decided that some special rules should still apply in determining the income derived from the mineral industries, in order to encourage exploration for and development of mineral deposits. These inducements are intended to encourage the establishment and growth of	Page 19, paragraph (3) of Brief This portion of the brief points out that the proposed earned depletion will inhibit the expansion of existing mines in favour of the development of marginal projects. Page 20, paragraph (4) of Brief This portion of brief points out that the proposal to restrict per-

Name: Anglo American Corporation of Canada Limited

Principal Subject: The Industry Generally

(B) Earned Depletion (Continued)

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The mineral income on which this depletion allowance is based comprises the balance of the revenues remaining after deducting therefrom the operating costs, capital cost allowances claimed in the year, and any unamortized balance of exploration and development costs.	highly productive industry in areas of Canada outside those where rapid urban and industrial growth are already occurring. However, the special rules should be revised substantially to ensure that really profitable projects pay a fair share of the national revenues, as other industries do, and that the inducements offered are efficient.	centage depletion to properties owned at November 7, 1969 will inhibit the transfer of producing mining properties in the five year transitional period.
	1.51 Two main changes are proposed. The first would replace the three-year tax exemption for new mines with a special rule permitting capital costs of fixed assets purchased for the development and operation of a new mine to be charged off against income from that mine as quickly as desired. This change would take effect in 1974 at the expiration of the period for which the government in 1967 gave assurances that the three-year exemption would continue. The new rule would ensure that in the high-risk business of mining, taxes would not be paid until investments in new projects are recovered, but it would do so on a more economical basis than the present exemption.	Page 20, paragraph (6) of Brief This portion of the brief points out that the more a company spends on exploration in a year the smaller will be the portion of earned depletion available to it in that year.
In practice this means that a company which continues to spend money on exploration and development work is entitled to claim little or no percentage depletion of $33\frac{1}{3}\%$ of mineral profits.	1.52 The second change concerns depletion allowances. The existing maximums would continue to apply—generally no more than one-third of production profits—but a taxpayer could run out of depletion allowances unless he continues to explore for, and/or develop, Canadian minerals. Every \$3 of qualifying expenditures made after this White Paper is published would "earn" the taxpayer the right to \$1 of depletion allowances if and when his production profits permit. Depletion allowances on	Page 21, paragraph (7) of Brief This portion of the brief questions the adequacy of earned depletion of \$1 for every \$3 spent on exploration.
Persons who receive income in the form of a royalty or rental based on the amount of production from a mine or gas or oil well may		Page 21, paragraph (8) of Brief This portion of the brief suggests the earned depletion proposals are more attractive to the

claim a deduction of 25% of the gross amount of the rental or royalty.

new properties would have to be "earned depletion" immediately: "unearned" allowances would be continued for five years on existing properties as a transitional measure. This proposal is more fully explained in Chapter 5. That chapter also sets out other changes of detail applying to the mineral industry. They flow mainly from other more general changes proposed in the tax system.

5.25 The present rules concerning exploration and development costs accomplish the objective set out in the preceding paragraph: the costs of mineral exploration and development can be deducted for tax purposes early enough so that taxes will be applied only when it is clear that a project will be profitable. Under these rules, a corporation which has as its principal business either mining, the production of oil, or certain allied activities (refining and/or distributing petroleum or petroleum products, fabricating metals or operating pipelines), may deduct Canadian exploration and development costs as they are incurred. If these costs exceed the corporation's income, then it may deduct the balance of the costs in the first subsequent year in which it has enough income.

5.26 Other taxpayers may also deduct exploration and development costs as they are incurred, but if they do not meet the principal business test mentioned above, they may deduct them only from income from mineral properties. This rule has guaranteed that tax was not paid until these costs were recovered, but it has meant that taxpayers who were unsuccessful in their mineral projects have suffered losses that were not deductible for tax purposes. To cure this defect, it is proposed that taxpayers who fail to meet the principal business test be entitled to put their future exploration and development expenses in an asset class and to deduct annually part or all of their accumulated undeducted expenses up to a maximum of the greater of two amounts:

petroleum industry than to the mining industry.

In particular it points out that townsite and similar costs are very substantial in the case of a new mining project, but do not qualify for earned depletion.

Page 23, paragraphs (c), (d), (e) and (g) of Brief

This portion of the brief contains recommendations respecting the following:

(i) Effective incentives to accrue to the investor so that he will receive tax-free his share of earned depletion and accelerated capital cost allowances.

(ii) Earned depletion and accelerated depreciation should include an allowance for costs of development work carried out after production commences, the extension of existing mine assets and the costs of other assets, such as roads, harbour facilities and refineries.

(iii) Review of the adequacy of the proposed $1 for $3 to provide a more favourable basis.

(iv) Transitional provisions to ensure that properties acquired after November 7, 1969, be entitled to percentage depletion.

Name: Anglo American Corporation of Canada Limited

Principal Subject: The Mining Industry Generally

(B) Earned Depletion (Continued)

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	(1) their income from mineral properties before any deduction in respect of exploration and development expenses, or (2) 20 per cent of the net book value of the class. For this purpose, income from mineral properties would include producing profits, royalties received, and the proceeds of the sale of mineral rights. 5.29 In addition to their exploration and development expenditures, mining corporations spend large sums of money on mining machinery and buildings before they know whether their new mine will be profitable. In order to recognize this risk, the government proposes to put depreciable assets of this type acquired for production from a particular new mine in a separate asset class and to permit the taxpayer to write them off for tax purposes just as fast as he has enough income from the new mine to absorb the charge. The assets concerned are those described in paragraphs (g) and (k) of class 10, which read as follows: "(g) a building acquired for the purpose of gaining or producing income from a mine (except an office building that is not situated on the mine property and a refinery) "(k) mining machinery and equipment acquired for the purpose of gaining or producing income from a mine." 5.30 This provision would not replace the existing right to deduct 30 per cent of the net book value of assets in this class: It would supplement it. If the new mine produces sufficient profit to absorb a deduction of more than 30 per cent, the taxpayer	

could make that deduction. If it does not he could nevertheless deduct up to 30 per cent if he chooses, thereby either reducing other income or producing a business loss which could be offset against income in other years.

5.31 Once the provisions concerning exploration and development costs, the costs of acquiring mineral rights, and the costs of mining machinery and buildings are in place, taxpayers can be pretty well assured that they would not be taxed on mining ventures until after they recover their investment. Having provided that assurance, the government proposes to phase out the present three-year exemption for new mines.

5.35 The present three-year exemption would continue to apply until December 31, 1973, in accordance with the announcement made by the then Minister of Finance in May, 1967. New mines which have come into production in commercial quantities before the publication of this White Paper would be eligible for the exemption but would not be able to take advantage of the new proposal concerning fast write-off. New mines which come into production after the publication of this White Paper but before January 1, 1974 would be entitled to elect to take advantage of either incentive but not both. Specifically, they would be entitled to claim exemption of the profits earned either in the first three years of operation or in the period remaining to January 1, 1974, if that is shorter. At the end of the exempt period they would be entitled to the fast write-off of the capital cost of their mine assets, but only if they reduce the book value of those assets by the full amount of their exempt profits.

5.36 At present, the act provides that operators of mineral resources, and this phrase includes oil and gas wells, are entitled to reduce their taxable income by claiming depletion allowances. For the most part these depletion allowances are calculated as a percentage of the profits derived from produc-

Name: Anglo American Corporation of Canada Limited

Date Brief Received:

Principal Subject: The Mining Industry Generally
(B) Earned Depletion

Present Tax Law

Tax Reform Proposals

tion from the mineral resource, and the usual percentage is $33\frac{1}{3}$ per cent. Special rates of depletion are provided for gold and for coal.

5.40 The government believes that both of these inefficiencies can be substantially reduced if depletion allowances are more directly related to the activities which it is desired to affect. Consequently it is proposed that, after a suitable transitional period in respect of mineral rights held by the taxpayer on the day this White Paper is published, depletion allowances would have to be "earned". The existing maximums would continue to apply—that is, generally no more than $\frac{1}{3}$ of production profits—but a taxpayer could only deduct these maximums, or any amount, if he spends enough on exploration for or development of mineral deposits in Canada or on those fixed assets described in paragraph 5.29 that are acquired for the exploitation of a new Canadian mine. The formula proposed is that for every $3 of eligible expenditures made after this White Paper is published a taxpayer would earn the right to $1 of depletion allowance. If his profits that year are not sufficient to permit him to deduct the amount earned, he could carry the undeducted amount over to subsequent years. The cost of acquiring mineral rights would not be an eligible expenditure for this purpose.

5.41 Under the proposed system, a taxpayer could run out of depletion allowances unless he continues to explore for, and/or develop, Canadian minerals. Once the system is fully effective, a taxpayers' allowances would end when his profits

Principal Points of Brief

before "eligible expenditures" exceed twice the amount of those expenditures. Consider the following example:

Profits before eligible expenditures	\$6,003
Deduct eligible expenditures	3,000
	3,003
Maximum depletion \$1,001 (⅓ of \$3,003)	
Earned depletion (⅓ of \$3,000)	1,000
Taxable income	\$2,003

5.42 The system would not become fully effective immediately. The government proposes that for the first five years of the new system taxpayers be entitled to depletion allowances in respect of production profits from properties they now own without having to "earn" them. This period, combined with the entitlements to the earned allowances that taxpayers would be able to accumulate between the publication of this White Paper and the end of 1975, should enable the mineral industries to make a smooth transition to the new system.

5.43 Under the present legislation a depletion allowance of 25 per cent may be deducted by non-operators from their income from mineral properties. This provision applies principally to the holders of royalties. The concession sought to recognize that royalties might well in part be a return of capital. This fact would under the present proposals be more accurately recognized by the proposed rules concerning the amortization of the cost of acquiring mineral rights. Therefore it is proposed that the percentage depletion at present available to non-operators be repealed.

Name: Anglo American Corporation of Canada Limited

Date Brief Received:

Principal Subject: The Mining Industry Generally
(C) Purchase or Sale of Mineral Properties

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Under the present Income Tax Act, the cost of purchasing mineral leases or properites cannot be deducted in computing the income of the purchaser. Conversely, proceeds of the sale of such leases or properties are not income to the vendor.	The proposals of the White Paper relating to the cost of mineral leases are as follows: 5.27 Since 1962, the cost of acquiring oil rights or natural gas rights has been included in the definition of exploration and development expenses. Consequently these costs have been deductible for tax purposes within the limits of the rules relating to exploration and development expenses. It is proposed that this rule be retained, and that it be expanded to cover the costs of other mineral rights. 5.28 Also since 1962, the proceeds of sale of oil rights and natural gas rights have been treated as taxable income. As part of the proposal to tax capital gains, this rule would also be extended to apply to all mineral rights. A special rule would be applied to the proceeds of the sale of rights which are held on the day this White Paper is published if the proceeds of the sale of those rights would not have been income for tax purposes under the existing rules. This special, transitional rule is similar to that proposed in paragraph 5.8 with respect to existing goodwill; if the sale is in the first year of the new system, only 60 per cent of the proceeds would be taken into account; if in the second year, 65 per cent; the third year 70 per cent; and so on, increasing by 5 per cent each year until all of the proceeds are taken into income if the sale is in the ninth or a subsequent year. Since the cost of these rights would henceforth be deductible for tax purposes, prices should rise and this system should produce a fair after-tax return to the present owners.	Page 20, paragraph (5) of Brief This portion of the brief states that the tax to be imposed on gains realized from the sale of mining properties will impede the development of properties. Page 24, paragraph (f) of Brief This portion of brief recommends that gains on sale of mining properties not be taxed until shares received as sales consideration have been sold.

(D) Offshore Exploration Expenses

The provisions of the present Income Tax Act and Income Tax Regulations do not permit a Canadian mining company deduction for exploration and development costs incurred on non-Canadian properties. Canadian oil and gas companies are allowed a deduction for drilling costs incurred outside of Canada, provided there is income received from an oil or gas well outside of Canada. (Section 1204 of the Regulations).	The White Paper makes no reference to offshore exploration costs, so presumably feels the present arrangements are satisfactory.	Page 22, paragraph (9) of Brief This portion of brief points out that the White Paper makes no reference to offshore exploration.

(E) Income Bonds

Sections 8-3, 12-1-f and 139-1-t of the Income Tax Act These sections provide that interest paid on an income bond (that is, interest that is payable only if the debtor earns a profit) (a) is not allowed as a deduction to the debtor, and (b) is treated as though it were a dividend from a Canadian company received by the creditor.	The White Paper makes no reference to income bonds.	Page 22, paragraph (10) of Brief This portion of the Brief points out that the White Paper makes no reference to Income bonds or debentures.

Name: Anglo American Corporation of Canada Limited

Date Brief Received:

Principal Subject: Temporary Residence Abroad

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 29 of the Income Tax Act This section provides that a person who is a resident of Canada for part of a year and who is not a resident of Canada for another part of the year shall pay annual Canadian income taxes on the part of his income received by him while resident in Canada. Ordinarily, a Canadian who leaves Canada for a temporary period only continues to be regarded as a resident of Canada and is subjected to Canadian taxes on his income, whether earned in Canada or elsewhere.	The White Paper apparently does not propose any change in the legislation respecting the determination of residence in Canada. Under the heading of Capital Gains, the following paragraph proposes a general rule when a taxpayer gives up Canadian residence or moves to Canada. 3.40 The other deemed realization would occur when a taxpayer gives up Canadian residence. The general rule would be that he would be treated as if he had sold all his assets on that day at their fair market value. On the other hand, when a taxpayer moves to Canada he would generally be treated as though he had on that day purchased his assets at their fair market value. The combination of these two rules would mean that Canada would tax only the increase in value that arises during the time that the owner is resident in Canada.	Page 25 of Brief This portion of the brief suggests: (a) Canadian residents transferred out of Canada for a temporary period continue to be treated as residents of Canada, and (b) Non-residents transferred to Canada on a temporary basis should be taxed in Canada only on income earned here and capital gains realized here, and not be taxed in Canada on gains realized abroad, unless the proceeds are remitted to Canada. (This latter recommendation is based on the tax laws of the United Kingdom).
Section 31 of the Income Tax Act This section provides that a non-resident person who receives income for duties performed in Canada must pay annual Canadian income taxes on his Canadian income.	It is not clear whether the above proposed general rule applies only to persons leaving Canada permanently or moving to Canada on a permanent basis, or will also apply to temporary transfers.	

Principal Subject: Administration—Advance Rulings

No provisions in Income Tax Act. It is not the practice of the Taxation Division of the Department of National Revenue to issue advance rulings on the tax liabilities that may arise if a proposed plan of action is adopted.	No proposals are contained in the White Paper.	Page 26 of Brief. This portion of brief recommends adoption of system in force in the United States of making advance tax rulings available in the case of mergers and amalgamations.

APPENDIX "C"

Brief To The

Standing Senate Committee
on Banking, Trade, and Commerce

Regarding the

"WHITE PAPER ON TAX REFORM"

Submitted by

The Council of the Forest Industries
of
British Columbia

March 1970

This brief is submitted by the Council of the Forest Industries of British Columbia, on behalf of its member companies.

These companies engage in logging, and the manufacture of lumber, plywood, shingles and shakes, pulp and paper, and together are responsible for 85 per cent of the value of forest products produced in British Columbia.

Canada requires a tax system which:

(a) restricts as little as possible the growth of the economy;

(b) is equitable; and,

(c) is simple to comply with and administer.

The Council of the Forest Industries of British Columbia submits that a number of the proposals contained in the "White Paper on Tax Reform" would not serve to achieve these ends. In particular, the Council is critical of the following aspects and has certain alternatives to propose:

1. Economic effects

1.1 The imposition of a capital gains tax in its proposed form would seriously impair the amount of capital funds generated within Canada and deter the very necessary inflow of foreign capital. Genuine long-term investment gains should remain tax-free in order to maintain a maximum incentive for investment. However, if it is absolutely essential to Canada's revenue requirements that these gains be taxed, we submit that it should be at a low rate which will not impair the generation of capital. Further, in order to avoid the unjust taxation of inflation, the rate of tax should be graduated as to the time period that the asset was held.

1.2 Small companies have greater difficulty in the raising of capital for growth than do large companies. The profits now re-invested to provide growth capital would be substantially reduced if the low rate of tax was removed. The small company must not be deprived of this or an equivalent incentive.

1.3 The proposals contained in the "White Paper" would have the effect of reducing personal and corporate savings and increasing spending. Inflation would be the result. A credibility gap already exists with regard to the ability of government to curb inflation.

1.4 The Government forecasts additional revenues through the implementation of the "White Paper" proposals. It is submitted that it is not an opportune time to provide for additional revenues for which a need has not been explained. The Canadian economy requires that first priority be given to a study of Government expenditures.

2. Five year revaluation

It is submitted that it is discriminatory and unjust to tax one form of investment on an accrual basis when all others are taxed on a realized basis. Earnings of shareholders of

otherwise identical companies will be taxed in different ways just because one happens to have stock listed on a Canadian stock exchange.

It has been the policy of recent Governments to encourage Canadian ownership in foreign controlled companies. Shareholders of companies which became "good citizens" by issuing stock to the Canadian public would be discriminated against compared to companies which do not have Canadian ownership.

3. Taxation of private homes

The principle of taxing certain gains on the sale of a home is not acceptable. To many Canadians, their home is their principal asset. As a general rule, the proceeds from the sale of a home are re-invested in another home or are used as a source of retirement income. To tax either is unduly harsh as it is a tax on inflation.

We recommend that, rather than establish arbitrary exemptions with the intention of taxing only "windfall" gains, the proposal be withdrawn completely.

4. Tax on the sale of personal possessions

The proposal to tax gains on the sale of personal possessions whose cost exceeded $500 is fundamentally unsound as resultant revenue would almost certainly not compensate for the administrative burden imposed upon both taxpayer and tax authority alike. Also, if gains are taxed, then similar losses should be allowed without restriction, which would further reduce the resultant revenue.

5. Integration of corporate and personal tax

5.1 2½ year rule

It is proposed that taxes paid by a corporation be available to the shareholders in whole or in part as creditable tax provided that the earnings on which the tax is paid are distributed within 2½ years.

The Government has suggested that the distribution rule was proposed because of a fear that Government revenues could be seriously unbalanced if creditable tax was allowed to build up in a corporation. We believe that this fear is unfounded as earnings not initially distributed as dividends are used for corporate growth and it is very rare to declare dividends out of past earnings.

The 2½ year rule or any substitute should be abandoned because it would unnecessarily cause serious interference with the determination of corporate dividend policy and impose corporate growth restrictions.

5.2 Administration

The implementation of the creditable tax system will be unbelievably complex to comply with and administer. The normal situations alone create substantial problems because of differences between taxable income and corporate income, the treatment of foreign items and losses carried forward and backward.

The current proposals (not specified in the "White Paper") for the transitional period will add immeasurably to the complexity. The proposal to divert corporate tax to non-creditable tax pools represents in effect the taxation in advance of events which may never occur, such as the realization of depreciable property and goodwill, and also represents the retroactive taxation of gains accrued prior to "valuation day".

5.3 We submit that the overall effect of the integration system can be readily achieved by the Government increasing the present dividend tax credit to 25% and allowing refunds where the credit exceeds the tax otherwise payable. Any revenue loss resulting from granting tax credits where taxes are not being currently paid by the payer company is not sufficient justification for the proposed integration system with its attendant problems.

6. Business expenses

We fully support the principle of eliminating abuses in the deduction of entertainment and similar expenses, but believe the "White Paper" proposals are far too severe as most such expenditures are legitimate business expenses. Most large companies have rules for administering entertainment expenses incurred by their employees and it is suggested that the Government set up similar regulations rather than impose legislation that is unjust to most taxpayers in order to stop abuse by the minority.

7. Capital cost allowance

The "White Paper" implies that the existing capital cost allowance rates may be too generous and that the Government intends to invite briefs with respect to the subject. It is our opinion that the rates are generally satisfactory.

The British Columbia forest industry already bears a greater tax load than most of its foreign competitors. Any further inroads into the cash flow of the corporations involved should be carefully considered before implementation of any change.

8. Competitive position of the British Columbia forest industry

British Columbia's forests are large enough to permit a doubling of the volume of wood processed and consequently British Columbia has a great need of capital, provided its competitive position in world markets can be maintained and improved. However, the forest industry in British Columbia already bears a larger tax burden than its foreign competitors, which together with the stringent tax installment schedule already impose an excessive inroad into the cash flow of forest industry corporations in British Columbia.

Not only would the proposals made in the "White Paper" inhibit the accumulation of necessary capital for expansion, they would also increase this tax burden to the point where the industry would likely find it impossible to maintain, let alone increase, its exports into the United States and other countries. Government policy should encourage the growth in Canada of strong, world competitive industries, not inhibit them and preserve inefficiency.

9. Capital invested in timber and cutting rights

The forest industry is relatively unique with respect to the long periods of time which elapse during which substantial amounts of capital are tied up in the industry's basic raw material, i.e., standing timber and/or cutting rights thereto. This necessary utilization of capital far exceeds the raw material inventory demands on the capital of most other commercial enterprises.

In the United States, this factor is recognized and is relieved to some extent by a special provision of the United States Internal Revenue Code.

Under Section 631 of the United States Code, a forest industry company which retains standing timber or a right to cut standing timber for more than six months may capitalize as and when cut, any increase in value which may have occurred in such standing timber or cutting right. The total value is allowed as a deduction when determining ordinary income and the capitalized increase in value taxed as a capital gain at a lower rate.

The Canadian forest industry obtains very large amounts of crucially needed foreign exchange as a result of its product exports to the United States. Accordingly, the favourable tax climate under which the United States forest industry companies operate as compared to the very heavy tax burden of the Canadian companies will become an increasingly important factor in determining whether Canadian forest industry world exports decrease or increase.

Serious consideration should be given, therefore, to recognizing through the Canadian tax structure the heavy burden borne by the Canadian forest industry in carrying inventories of standing timber and/or cutting rights thereto.

In conclusion,

(a) The Council recognizes that there are inequities and shortcomings in our present system of taxation which must be corrected. The existing Income Tax Act can be readily changed to incorporate the many acceptable but less radical proposals in the "White Paper".

(b) The Council supports the principle of relieving the tax burden on the lowest income groups and re-apportioning it in an equitable manner amongst other taxpayers. The Council approves of the provision of a uniform rate of tax for all corporations as long as a workable partnership election is available and if an alternative form of incentive can be offered to small companies.

(c) The Council cannot support the capital gains tax proposals in their present form as they would severely impair the amount of capital funds generated within Canada and deter the very necessary inflow of foreign capital.

(d) A prerequisite of many of the proposals is Provincial cooperation. The excessive burden imposed on our industry by the income tax payable under the B.C. Logging Tax Act without proper offset is an example of the lack of Federal-Provincial cooperation already in existence. Another is the considerable disparity between the Federal and B.C. succession duty statutes.

(e) Finally, the Council cannot support the radical change in taxation policy which is implicit in the tax reform package put forward in the "White Paper". The danger is too great that the effect on the Canadian economy

would be severely damaging. The Government has not presented to the Canadian public reasonable proof of the economic effects nor justifications of the expected increase in revenue. The full economic effect of the proposal would only be known after the system has been in force for some time—when it could be too late to remedy the situation.

It is better to live with, and improve, a system of which the economic effects are known than to be pioneers and potential losers in an unpredictable reform.

Estimates of Production per Man-Year[1]
Logging
B.C. and Washington/Oregon

Board feet per man-year	1963–1968 Wash/Oregon	B.C.	Differential %
1963	594,904	498,362	19.3%
1964	610,820	490,833	24.4
1965	607,799	481,702	26.1
1966	617,984	529,026	16.8
1967	600,924	533,536	12·6
1968	654,321	557,500	17.3
% Change 1963–1968	9.9%	11.8%	
Average variation 6 year period			19.4%

Timber Harvest
Washington/Oregon (million f.b.m. Scribner Scale)
British Columbia (million f.b.m. B.C. Log Scale)

	Washington/Oregon[2]	British Columbia[3]
1963	14,104	8,676
1964	15,659	8,915
1965	15,866	9,030
1966	14,996	9,441
1967	14,293	9,267
1968	16,714	10,035

Employment
Washington/Oregon—British Columbia

	Washington/Oregon[4]	British Columbia[5]
1963	23,708	17,409
1964	25,636	18,163
1965	26,104	18,746
1966	24,266	17,846
1967	23,785	17,369
1968 (est.)[6]	25,544	18,000

[1]Source: J. Miyazawa
[2]Source: U.S. Forest Service
[3]Source: B.C. Forest Service
[4]Source: Oregon Dept. of Employment; Wash. Employment Security Dept.
[5]Source: D.B.S.—Census of Mfg. 1963–1967
[6]Source: C.F.I.

J. Miyazawa
5th March 1970

Comparison of Economics of Purchasing
Washington Grapple Yarder Model 108—Oregon Versus British Columbia

	Canadian Funds Oregon	Canadian Funds B.C.
	$	$
Capital cost including freight, taxes, etc.	151,000	202,000
Less present value of disposal at end of eight years	14,200	14,200
Net investment	136,800	187,800
Estimated labour and maintenance saving, average	49,900	46,200
Cumulative present value of after tax cash savings using 8% discount factor, eight years life, U.S. tax rate of 52.8%, Canadian tax rate of 56%		
Year 1	53,100	52,300
Year 2	92,700	91,200
Year 3	122,800	120,700
Year 4	146,200	143,400
Year 5	164,600	161,100
Year 6	180,400	176,000
Year 7	194,400	188,900
Year 8	206,900	200,200
Years to payout with 8% return	3.6 Years	6.9 Years

Depreciation rates
Canada—30% reducing balance
U.S. —33% reducing balance

GRAPPLE YARDER—WASHINGTON MODEL 108

(Canadian Funds)

Year	1	2	3	4	5	6	7	8
British Columbia								
Cost reductions	56.9	52.9	49.0	45.2	41.4	41.4	41.4	41.4
Tax @ 56%	31.9	29.6	27.4	25.3	3.2	23.2	23.2	23.2
Net before depreciation	25.0	23.3	21.6	19.9	18.2	18.2	18.2	18.2
Tax reduction by depreciation	29.4	20.6	14.4	10.1	7.1	4.9	3.4	2.4
Cash flow	54.4	43.9	36.0	30.0	25.3	23.1	21.6	20.6
8% discount factor	.961	.887	.819	.756	.698	.644	.595	.549
Present value of cash flow	52.3	38.9	29.5	22.7	17.7	14.9	12.9	11.3
—cumulative	52.3	91.2	120.7	143.4	161.1	176.0	188.9	200.2
Oregon								
Cost reductions	61.5	57.1	52.9	48.8	44.7	44.7	44.7	44.7
Tax @ 52.8%	32.5	30.1	27.9	25.8	23.6	23.6	23.6	23.6
Net before depreciation	29.0	27.0	25.0	23.0	21.1	21.1	21.1	21.1
Tax reduction by depreciation	26.3	17.6	11.8	7.9	5.3	3.5	2.4	1.6
Cash flow	55.3	44.6	36.8	30.9	26.4	24.6	23.5	22.7
8% discount factor	.961	.887	.819	.756	.698	.644	.595	.549
Present value of cash flow	53.1	39.6	30.1	23.4	18.4	15.8	14.0	12.5
—cumulative	53.1	92.7	122.8	146.2	164.6	180.4	194.4	206.9

Depreciation rates
Canada—30% reducing balance
U.S. —33% reducing balance

APPENDIX "D"

COUNCIL OF THE FOREST INDUSTRIES OF BRITISH COLUMBIA

Taxation of the Forest Industry

March 18, 1970

Analysis of Appendix "C" by Senior Advisor.

This brief is submitted on behalf of companies responsible for 85 per cent of the value of forest products produced in British Columbia.

The brief refers to several of the White Paper proposals, comprising:

(A) The lower rate of tax on the first $35,000 of taxable income.

(B) Capital Gains:

(i) Five year Revaluation.

(ii) Taxation of Private Homes and Personal Possessions.

(iii) General.

(C) Grossing-Up of Canadian Dividends—Dividends paid in 2½ year Period.

(D) Business and Entertaining Expenses. Expenses.

(E) Capital Cost Allowances.

(F) Competitive Position of Forest Industry.

(G) Capital Invested and Cutting Rights,

Members of the Committee may be interested in the final recommendation contained in the brief, which is:

"Finally, the Council cannot support the radical change in taxation policy which is implicit in the tax reform package put forward in the 'White Paper'. The danger is too great that the effect on the Canadian economy would be severely damaging. The Government has not presented to the Canadian public reasonable proof of the economic effects nor justifications of the expected increase in revenue. The full economic effect of the proposal would only be known after the system has been in force for some time—when it could be too late to remedy the situation.

"It is better to live with, and improve, a system of which the economic effects are known then to be pioneers and potential losers in an unpredictable reform." (Page 11, paragraph (e))

There is attached the usual summary of present tax laws, White Paper proposals and the principal points of the brief.

Name: Council of the Forest Industries of British Columbia

Date Brief Received:

Principal Subject: Lower Rate of Tax on First $35,000 of Taxable Income

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The provisions of the present Income Tax Act impose a graduated tax on the taxable incomes of all Canadian companies of: (i) 23% of the first $35,000 of taxable income, and (ii) 53% of taxable income in excess of $35,000.	The proposals of the White Paper referring to the taxation of small businesses are dealt with in Special Study No. 5. They are not repeated here.	Page 2, paragraph (1.2) of Brief This portion refers to the impact on the small business if the lower rate of tax on the first $35,000 of taxable income is removed.

Principal Subject: Capital Gains

(A) Five Year Revaluation

There is no reference to this subject in the present Income Tax Act.	3.17 Once the tax on capital gains had been part of the system for a few years, taxpayers would begin to report gains that had accrued over several years. In the absence of special provisions, this could result in a much larger than usual income in that year and could make the taxpayer liable for a marginal rate of tax considerably higher than the rates that would have applied had his income been spread over the years during which the gain accrued. The averaging provisions described in Chapter 2 would overcome this effect. 3.33 Taxpayers other than widely-held Canadian corporations would include only one-half of their gains on the sale of these shares in taxable income and deduct only one-half of their losses. However, they would be required to revalue these shares to market value every five years and take one-half of the resulting gain or loss into account for tax purposes in that year. A special rate is proposed for widely-held Canadian corporations to avoid double tax. This is explained in Chapter 4. 3.34 The rule that only one-half of gains or losses would be taken into account for tax purposes would put Canadians in approximately the same tax position regarding capital gains and losses on these shares as most of the non-residents who invest in Canada. Specifically, it would put them on approximately the same footing as American individuals and corporations and British individuals and corporations. (It would be impracticable to attempt to tax non-residents on their profits on the sale of small blocks of publicly listed Canadian shares.)	**Page 3, paragraph (2) of Brief** This part of the brief comments on the five year revaluation of shares of widely-held Canadian corporations.

Name: Council of the Forest Industries of British Columbia

Date Brief Received:

Principal Subject: Capital Gains

(A) Five Year Revaluation

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	3.35 The 50-per-cent taxability of such gains, coupled with the 50-per-cent credit for corporate tax paid by such corporations, should also result in a relatively balanced system in which there is little incentive for Canadians to receive their income in the form of capital gains rather than dividends, or vice versa. Again this balance is explained more fully in Chapter 4. 3.36 The proposal that the accrued gains or losses on those shares be taken into account every five years is one of two exceptions to the general rule that capital gains and losses would be taxable only when they are realized. (The other exception concerns taxpayers who leave Canada.) Periodic revaluation would reduce somewhat the value of the half-gains rule. It would reflect the fact that these shares are readily marketable and that a taxpayer can, therefore, realize his gain or loss fairly easily at the time of his choosing. The shares of private companies do not have the same marketability. 3.37 Periodic revaluation would also reduce the "lock-in" effect that might well otherwise occur. If a taxpayer faces a tax on the sale of an investment, and that tax is postponed if he holds on to the investment, he may feel "locked in". As long as he holds, he would have, say, $100 working for him. If he sells, he would have only, say, $90 or $95 to reinvest. Since periodic revaluation would reduce this lock-in effect it would reduce what might otherwise be an obstacle to the workings of the capital market. Revaluation would also make it feasible for the government to classify more corporate reorganizations and mergers as tax-free	

transactions than would otherwise be the case, thus removing a tax barrier that might otherwise have impeded transactions that are desirable for economic reasons. Finally, it would reduce the tax postponement which would otherwise result from the treatment suggested in paragraph 3.42 to those cases where the lack of marketability of the assets made the treatment compelling.

3.38 The process would not begin until five years after capital gains become taxable. Beginning in the fifth year, individual taxpayers would revalue their holdings of shares of widely-held Canadian corporations in each year in which they attain an age that is divisible by five. Corporations would also revalue their holdings of these shares every five years, likely on the fifth anniversary of incorporation and each other anniversary divisible by five. Dispersing the valuation process through a five-year cycle would reduce the pressure in any particular year—the pressure of the work load on the administration and the pressure that might otherwise develop on market prices every five years. To further disperse this latter pressure, it is proposed that revaluation take place as of the end of the month in which the significant birthday or anniversary takes place.

Name: Council of the Forest Industries of British Columbia

Date Brief Received:

Principal Subject: Capital Gains

(B) Taxation of Private Homes and Personal Possessions

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
There is no similar provision in the present Income Tax Act.	3.19 Generally, capital gains on the sale of homes would not be taxed. This would be accomplished by providing that only when a taxpayer sells his principal residence only the profit in excess of $1,000 per year of occupancy would be taxed, and by granting the "rollover" discussed in the next paragraph. Both of these provisions would of course apply on the sale of a farm with farmhouse that has been a principal residence. The $1,000 per year exemption would also compensate for the fact that losses on the sale of a taxpayer's residence other than a farmhouse sold with the farm, would not be deductible from income for tax purposes. The government believes it would be virtually impossible to distinguish between losses which arise from changes in the real estate market and losses which arise from the aging of the house and normal wear and tear. Naturally in calculating his profit the taxpayer would be able to take into account the cost of the improvements he has made. If he does not bother to keep records, he would be allowed instead a home improvement allowance of $150 per year of occupancy.	Page 4, paragraphs (3) and (4) of Brief This portion of the brief comments on these proposals.
	3.20 In addition to the exemption, the government proposes that a taxpayer who moves from one area to another within Canada in connection with a change of job should be entitled to treat the sale of his home and the purchase of a home in the new area as a non-taxable transaction. In technical terms, he would be granted a "rollover". If the taxpayer spends the proceeds of the sale of one house on the purchase of another within a year from the date of the sale, any profit that would be taxable on the sale of the old house (that is, after deducting	

the exemption) would be deducted from the cost to him of the new house. In this way, the profit would increase his gain on the ultimate sale of his new house (or reduce his loss), and tax would not be due before that time.

3.21 A taxpayer who has two homes could only claim the exemption or the rollover with respect to one of them. He would have to declare which is his principal residence. Similarly, a husband and wife would have to choose one principal residence for both of them, unless they are separated pursuant to a divorce, judicial separation or written separation agreement.

3.22 This category would include such things as cars, boats, stamp colections, paintings, sculptures and cottages, etc. It might, therefore, include assets that the owner hopes can be resold later for more than they cost after he has had the use or enjoyment of them for a time.

3.23 If all profits on this type of asset were to be taxable, Canadians would have to become a nation of bookkeepers. The government proposes a rule which should have the effect of significantly reducing this record-keeping. When a taxpayer sells such an asset, he would not be taxed unless the proceeds exceed $500. If the proceeds do exceed $500 he could deduct from those proceeds either his cost or $500 whichever is the greater. This would have the result that Canadians need keep a record of the purchase of items of this type of personal property only if the cost of the item exceeds $500. To protect the revenue it would be necessary to provide that a series of sales of items of a set would be treated as one sale in applying the $500 limit.

3.24 As a companion to the $500 rule on gains, losses would not be deductible unless the item sold cost more than $500. If an asset did cost more than $500, the deductible loss would be computed by deducting from the cost either the proceeds or $500, whichever is greater.

Name: Council of the Forest Industries of British Columbia

Date Brief Received:

Principal Subject: Capital Gains

(B) Taxation of Private Homes and Personal Possessions

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	3.25 Because this category of assets involves items bought for personal use or enjoyment, it would also be necessary to impose some over-all limitations on the deductibility of losses. Otherwise, some taxpayers could reduce their taxable income by deducting personal expenses. Therefore, the government proposes that if an item in this category is of the nature that it depreciates through use, a loss on the sale of this item would not be deductible. Examples of this type of asset would include furniture, cars, boats and cottages held for personal use.	
	3.26 A second type of asset within the general category does not decrease in value through use. In this group one would include paintings, sculptures, jewellery and coin and stamp collection. However, in order to recognize the personal nature of these assets and of the losses resulting on their sale, the government proposes that such losses be deducted only from gains realized on the sale of the same type of asset. If the taxpayer does not have enough taxable gains of this nature in the same year to absorb the deductible loss, the balance could be offset against such gains either in the immediately preceding year or in the year immediately following.	

(C) General

Page 2, paragraphs (1.1), (1.3) and (1.4) of Brief

This portion of the Brief comments on the impact of taxation of capital gains.

Name: Council of the Forest Industries of British Columbia

Date Brief Received:

Principal Subject: Grossing-Up of Canadian Dividends

(A) Dividend distributions in $2\frac{1}{2}$ Year Period

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Under the present Income Tax Act: (a) Corporations pay annual income taxes of a lesser amount on the first $35,000 of taxable income and of a larger amount on taxable income in excess of $35,000. (b) Dividends generally flow free of tax between Canadian companies. (c) Canadian shareholders who are individuals pay income tax on dividends received and deduct 20% of Canadian dividends received from the income taxes payable by them. (d) Non-resident shareholders pay a 10% or 15% Canadian tax on dividends received.	The proposals in the White Paper respecting the grossing-up of Canadian dividends are set out in Special Study No. 4. They are not repeated here.	Page 5, paragraphs (5.1), (5.2) and (5.3) of Brief This portion of the brief comments on this proposal.

Principal Subject: Business and Entertaining Expenses

Section 12-2 of the Income Tax Act This section permits the Taxation Division to limit the deduction of any expense claim they consider to be unreasonable.	1.35 Various fringe benefits received by employees or by owners of businesses would be included in income for the first time. For example, an employee or owner of a business with a business-owned car available for his personal use would be required to include a minimum amount in his taxable income unless he pays the business at least that amount for the use of the car. There are other fringe benefits whose value cannot readily be measured in the hands of the recipient; for example, the use of hunting and fishing lodges, yachts and airplanes, the payment of social and recreational club dues, and the entertainment costs that are included in expense accounts. These costs would no longer be deductible to the employer. 2.11 The government has considered this issue at length. It proposes two sets of measures to remedy the disparity. First, in regard to those in business and the professions, and to certain types of benefits granted by employers to senior employees, it intends to set more rigorous limits to check "expense account living." The costs of attending conventions and belonging to clubs would no longer be permitted as a charge in determining business income. The costs of yachts, hunting and fishing lodges or camps, amounts spent for tickets for games and performances, and costs of entertainment would also be excluded. Owners or employees of a business having a car or aircraft available to them for their personal use, including travel to and from home, would have to pay the business a minimum stand-by charge, or have a corresponding amount added to their personal income for tax purposes.	Page 7, paragraph (6) of Brief This portion of the brief comments on the proposal to eliminate the deduction of entertainment expenses.

Name: Council of the Forest Industries of British Columbia

Date Brief Received:

Principal Subject: Business and Entertaining Expenses

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	5.9 Although the government believes that provision should be made for the deduction of legitimate business expenses that have not previously been deductible, it also believes that the present system permits deduction of certain types of expenses which taxpayers should be expected to meet out of tax-paid income. Consequently it is proposed that the Income Tax Act specifically deny deduction for entertainment expenses, the costs of attending or sending employees to conventions, and the cost of dues for membership in social or recreational clubs. This provision would not prohibit the expenditure of funds for these purposes, but it would ensure that taxpayers who wish to make such expenditures would do so out of after-tax dollars.	
	5.10 Under the system outlined in Chapter 4, whereby shareholders are given credit for the tax paid by their corporations, merely denying a deduction for this type of expenditure is not sufficient. Although the denial of the deduction would mean that the corporation pays extra tax, the shareholders of the corporation would receive credit for the extra tax paid. Therefore, it is necessary to provide further that, in the case of corporate taxpayers, taxes due because of the non-deductibility of these expenditures would not be creditable.	

Section 11-1-a of the Income Tax Act and Part XI of the Income Tax Regulations

These sections permit a taxpayer to deduct capital cost allowances (computed on a declining balance basis) from income subject to tax.

Most Canadians appear satisfied with the present system.

5.14 The system has without doubt proven easy to comply with, and has caused far fewer difficulties between taxpayer and taxgatherer than the more usual "straight-line" system that preceded it in 1948 and earlier years. One of the reasons that it works so well may be because, on balance, the rates tend to be on the generous side. This generosity has acted as an incentive to taxpayers to modernize and improve their business facilities, but naturally at some cost in government revenue. The royal commission did not recommend reductions in depreciation rates. Perhaps for that reason, the rates were not generally an issue in the public debate on tax reform that has taken place over the past two years. Nevertheless some have suggested that they are too generous, and the government believes that after 20 years of the system it is time for a review. However, depreciation is an important aspect of the tax system and taxpayers should have an opportunity to put forward their views and experience before major changes are considered. Therefore, the government intends in due course to invite briefs on the system and rates of capital cost allowance.

Page 7, paragraph (7) of Brief

This portion of the brief expresses satisfaction with existing rates of capital cost allowances.

Name: Council of the Forest Industries of British Columbia

Date Brief Received:

Principal Subject: Competitive Position of the British Columbia Forest Industry

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		Page 8, paragraph (8) of Brief This part of the brief forecasts of the impact of the White Paper proposals on the forest industry of British Columbia.

Principal Subject: Capital Invested in Timber and Cutting Rights

Our present tax law permits the cost of cutting rights to be amortized against income as the standing timber is cut.	The White Paper makes no proposals respecting cutting rights.	Page 9, paragraph (9) of Brief This portion of the brief contrasts the heavy Canadian tax burden with the lighter tax burden in the United States on the forest industry.

APPENDIX "E"

Addenda to Special Study No. 5.

SCHEDULE COMPARING NUMBER OF CORPORATIONS WITH NUMBER OF UNINCORPORATED BUSINESSES AND WITH NUMBER OF FARMS, AND SHOWING AVERAGE TAXABLE INCOME OF EACH IN THE YEAR 1967

(Based on information supplied by Minister of Finance under date of February 11, 1970 and statistics published in Taxation Statistics—1969 Edition)

	Corporations		Business Proprietors and Self-employed Professionals		Farmers	
Taxable Income Ranges	Number	Average Taxable Income	Number	Average Taxable Income	Number	Average Taxable Income
Under $ 2,000	18,612	830	21,017	372	13,826	334
$ 2,000 to 5,000	15,523	3,326	117,716	1,320	73,276	1,168
5,000 to 10,000	15,521	7,236	97,558	4,171	45,938	3,938
10,000 to 20,000	16,356	14,323	43,667	10,418	13,658	9,832
20,000 to 25,000			7,875	18,068	1,103	18,577
25,000 and over			16,292	33,992	924	29,784
20,000 to 35,000	15,354	28,166				
35,000 and over	10,913	350,902				
	92,279		304,125		148,725	

Note: The taxable income of smaller corporations is computed after deducting salaries paid to shareholder-executives.

The taxable income of proprietors and farmers is computed without any allowance for personal salaries.

Therefore, the average taxable income of corporations cannot be compared with the average taxable income of unincorporated businessmen and farmers.

Queen's Printer for Canada, Ottawa, 1970

Second Session—Twenty-eighth Parliament

1969-70

THE SENATE OF CANADA

PROCEEDINGS

OF THE

STANDING SENATE COMMITTEE

ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 14

WEDNESDAY, APRIL 8th, 1970

Eighth Proceedings on the Government White Paper,

entitled:

"PROPOSALS FOR TAX REFORM"

WITNESSES:

(For list of witnesses see Minutes of Proceedings—Page 14:5)

APPENDICES:

"A"—Brief from Imperial Oil Limited.
"B"—Analysis of Appendix "A" by Senior Advisor.
"C"—Brief from Elgistan Management Limited and associated companies.
"D"—Analysis of Appendix 'C" by Senior Advisor.
"E"—Brief from William M. Mercer Limited. (Employee benefit plans).
"F"—Analysis of Appendix "E" by Senior Advisor.
"G"—Brief from William M. Mercer Limited. (Taxation of lump sum payments).
"H"—Analysis of Appendix "G" by Senior Advisor.
"I"—Brief from The Royal Architectural Institute of Canada.
"J"—Analysis of Appendix "I" by Senior Advisor.

21817—1

THE STANDING SENATE COMMITTEE ON
BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aseltine	Desruisseaux	Kinley
Beaubien	Everett	Lang
Benidickson	Gélinas	Leonard
Blois	Giguère	Macnaughton
Burchill	Grosart	Molson
Carter	Haig	Phillips (*Rigaud*)
Choquette	Hayden	Walker
Connolly (*Ottawa West*)	Hays	Welch
Cook	Hollett	White
Croll	Isnor	Willis—(30)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

"With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intituled: "Proposals for Tax Reform", prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

"With leave of the Senate,

The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Hayden:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

ROBERT FORTIER,
Clerk of the Senate.

21817—1½

MINUTES OF PROCEEDINGS

MORNING SITTING

WEDNESDAY, April 8th, 1970.
(18)

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to further consider:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Hayden (*Chairman*), Beaubien, Blois, Burchill, Carter, Connolly (*Ottawa West*), Cook, Croll, Flynn, Everett, Giguere, Haig, Hays, Hollett, Isnor, Lang, Martin, Molson and Welch—(19).

Present, but not of the Committee: The Honourable Senators Fergusson, Laird and Methot—(3).

In attendance: Arthur W. Gilmour, Senior Advisor; Alan J. Irving, Legal Advisor and Roland B. Breton, Executive Secretary.

The following witnesses were heard:

Imperial Oil Limited

Mr. W. O. Twaits, Director and President.
Mr. J. W. Hamilton, Director and Vice-President.
Mr. J. F. Barrett, General Counsel.
Mr. S. E. Ewens, Manager, Tax Department.
Mr. E. D. K. Martin, Assistant Manager, Tax Department.
Mr. J. A. Armstrong, Director & Executive Vice-President.

Elgistan Management Limited:

Mr. J. D. H. Mackenzie, President.
Mr. G. P. Keeping, Company's Auditor & Tax Advisor.

At 12:30 p.m. the Committee adjourned.

AFTERNOON SITTING

2:00 p.m.
(19)

At 2:00 p.m. the Committee *Resumed.*

Present: The Honourable Senators Hayden (*Chairman*), Beaubien, Blois, Burchill, Carter, Connolly (*Ottawa West*), Cook, Everett, Haig, Hays, Hollett, Isnor, Lang, Molson, Welch and Willis.—(16).

Present, but not of the Committee: The Honourable Senators Laird, McDonald and Sullivan—(3).

In attendance: Arthur W. Gilmour, Senior Advisor; Alan J. Irving, Legal Advisor and Roland B. Breton, Executive Secretary.

The following witnesses were heard:

William M. Mercer Limited:

Mr. K. O. Macgowan, President.
Mr. L. E. Coward, Executive Vice-President, Central Region.

William M. Mercer Limited (endorsed by interested companies):

Mr. L. E. Coward, Executive Vice-President, Central Region.

Mr. O. B. Mabee, Vice-President, Personnel & Public Relations. (Simpsons Ltd.)

Mr. F. R. Southmayd, Vice-President of Finance, (Simpsons-Sears Ltd.)

Mr. T. VanZuiden, Treasurer & Asst. Secretary, (*Dominion Foundries & Steel Ltd.*)

The Royal Architectural Institute of Canada:

Mr. W. C. Leithead, President.

Mr. C. F. T. Rounthwaite, Honorary Treasurer.

Mr. W. A. Salter, Director of Professional Services.

Mr. J. P. Nelligan, Company's Solicitor.

Ordered,—That the documents submitted at the meeting today be printed as appendices to these proceedings, as follows:

A—Brief from Imperial Oil Limited.
B—Analysis of Appendix "A" by Senior Advisor.
C—Brief from Elgistan Management Limited and associated companies.
D—Analysis of Appendix "C" by Senior Advisor.
E—Brief from William M. Mercer Limited. (Employee benefit plans).
F—Analysis of Appendix "E" by Senior Advisor.
G—Brief from William M. Mercer Limited. (Taxation of lump sum payments).
H—Analysis of Appendix "G" by Senior Advisor.
I—Brief from The Royal Architectural Institute of Canada.
J—Analysis of Appendix "I" by Senior Advisor.

At 4:15 p.m. the Committee adjourned to the call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Ottawa, Wednesday, April 8, 1970

The Standing Senate Committee on Banking, Trade and Commerce, met this day at 9 a.m. to give further consideration to the White Paper entitled "Proposals for Tax Reform."

Senator Salter A. Hayden (Chairman) in the Chair.

The Chairman: Honourable senators, we have a heavy program today so I suggest we should get down to business right away.

The first submission this morning is from Imperial Oil Limited. Sitting to my immediate right is a man who is well known to you, Mr. W. O. Twaits, Director and President of Imperial Oil Limited.

Now, Mr. Twaits, would you like to take it from there?

Mr. W. O. Twaits, Director and President, Imperial Oil Limited: Thank you, Mr. Chairman. On my right is Mr. J. A. Armstrong, Executive Vice-President and Director, and then there is Mr. J. W. Hamilton, Vice-President and Director, Mr. J. F. Barrett, our General Counsel and Manager, Legal Department, Mr. S. E. Ewens, Manager, Tax Department, and Mr. E. D. K. Martin, Assistant Manager, Tax Department.

The Chairman: Now, Mr. Twaits, the order of beginning is in your hands.

Mr. Twaits: First of all, Mr. Chairman, we welcome this opportunity to appear before your committee and to discuss and present our views on the White Paper Proposals for Tax Reform.

These gentlemen, and I might say many others both inside and outside of our organization including learned counsel have been intensively studying the White Paper Proposals since last November. Parenthetically I might note that we have generally withheld public comment until we had completed our studies. Our conclusions, of course, are contained in the submission now in your hands and I have no intention of making a detailed review of that submission. However, I would like to present at this stage an opening statement.

I think you all know that Imperial as a company is over 90 years' old and has in fact grown up with the country. We currently have over 50,000 shareholders of whom 85 per cent or more than 43,000 are resident in Canada and we also have some 25,000 employees, agents and dealers. We are a fully integrated petroleum company with operations extending from the exploration phase through to the marketing of finished petroleum products. Our activities embrace a variety of associated interests including the manufacture and sale of chemicals, plastics, building products and exploration for mineral resources. We have operations in every area of the country with a long and rather proud tradition of pioneering. Our business is highly capital intensive. Over the past 10 years, Imperial's total expenditures for new plant, new equipment and exploration amounted to in excess of $1.2 billion, almost all of which represented the purchase of goods and services in Canada. We therefore have a naturally deep and continuing interest in the social and economic welfare of every section of the country.

As background to our views, I would note that the oil industry, including all its functions from exploration to the final product, is exposed to a bewildering variety of taxes and pseudo taxes which may not be realized by the general public but which does result in a tax burden for Imperial well above the national average. In 1969 the total taxes charged against income, together with Crown rentals, royalties, bonuses and other Government payments, was in excess of $149 million. In addition, we collected in excess of $233 million in gasoline and other taxes. In other words, we generated more than $4 in revenue for governments for each dollar of net earnings.

Our tax problems are quite different from those of the mining industry, with which petroleum is erroneously grouped frequently in statistical series. In fact, with increasing competition between sources and types of energy, taxation has become a major industry concern, both in terms of gross burden and lack of continuity in fiscal policy. In the decade ahead the industry faces the greatest capital demands in its history; and, of course, by corollary, a demand for skilled people. These are in order to satisfy not only normal growth, but the development of the North, the Continental Shelf and also extensive new refining and marketing facilities for motor fuels if we are to provide emission-free automobile engines. It is clear that this will not be accomplished unless fiscal policies at all levels of government provide an atmosphere conducive to risk capital and to capable people.

In a positive sense, Mr. Chairman, the views of the group represented here can be summarized as follows:

First, Canada is an advanced industrial country competing with larger nations in the world market. Taxes are a real competitive cost, and significant changes should not be undertaken without thorough committee review and public discussion, such as the White Paper permits.

Second, wholesale tax reform, as envisaged by the White Paper, cannot be administered or implemented without chaos, even with the proposed transition period. Progressive, stepwise change and examination of the impact is essential.

Third, we would endorse, without any order of preference or timing at the moment, the following proposals: (a) a tax on realized capital gains at a competitive rate not exceeding 25 per cent, excluding owner-occupied housing, personal property and any quinquennial revaluation of widely-held corporate securities—the latter being, in our opinion, an administratively horrendous and discriminatory concept; (b) retention of the present dividend tax credit as an alternative to the proposed integration concept, which we see to have serious market, administrative and financing implications; (c) retention of the present two-tier business tax for small businesses in order to encourage entrepreneurial growth; (d) raising exemption rates to relieve lower income groups as proposed in the White Paper; (e) a level of personal income taxes which reduces rather than increases present differentials versus the United States, an already serious handicap in retaining and training skilled management and technical personnel; (f) a depletion allowance for the petroleum industry calculated as a percentage of gross income from production at a rate at least more competitive with the current U.S. rate. This is as opposed to the present 33-1/3 per cent of net allowance and the White Paper proposal for the lesser of the present figure or 33-1/3 per cent of eligible expenditures. That sounds very complicated. What we are really saying is that both the present situation and the proposals in the White Paper place the Canadian operator at a substantial disadvantage versus the United States competitor. (g) Finally, we would endorse a major overhaul of administrative procedures to provide continuity of interpretation and a basis for corporate and personal planning.

We could pick out of the White Paper examples of what we regard as utter impracticability. I would name one, and that is the proposed tax on deemed realization on the shares held by foreign parents, and in our view there is the question, of course, of how you would collect such a tax on a rising market, but perhaps more important, what happens in a falling market to the Canadian Treasury; and this we see, as with regard to other proposals, as being in the sense of an impractical nature.

The Chairman: Right on that point, Mr. Twaits, if you do not mind an interjection...

Mr. Twaits: Not at all, sir.

The Chairman: On this deemed realization, if the foreign or non-resident owner of a controlling block of shares is faced with this deemed realization and he has no other potential income source in Canada, it looks to me like a proposition where it is "Heads I win and tails you lose" because if there is a gain on the deemed realization you have to pay taxes on it; and if there is a loss, where do you write it off?

Mr. Twaits: I could not agree with you more, Mr. Chairman, but maybe I could give you a concrete example, because we have taken an example with reference to our own shareholders.

If, for instance, the value of Imperial stock went up $10 a share in any five-year period, our parent company would be expected to pay a tax of about $220 million. I cannot quite understand how somebody is going to collect that tax, but assume that Imperial were made responsible for it. If all the dividends paid to

our own parent company today were sequestered, if you like, for this tax liability, that would take, even at present levels, five years to recover. If Imperial were held responsible by itself, we could not finance such a payment. If such unrealized gains were to be taxed, then the Government would have to permit foreign parent companies to deduct unrealized losses every five years, and if you had a $10 decline in Imperial shares, then I would find it hard to believe the Canadian Treasury would subject itself to a drain of $220 million. Is that an answer to your question, sir?

The Chairman: Yes, but it seems to me an indication that the thing is unworkable.

Senator Croll: Has not Mr. Benson made some clarification of that? I have not any notes with me on it, but, as I remember it, there was some further clarification on that point, which has arisen time and again. Are you aware of anything of that sort?

The Chairman: I have the position paper that he issued raising all these different points for discussion. The assumption seems to be that on the holdings of widely-held Canadian companies—and Imperial Oil qualifies for that position—they do not face this problem. This I cannot see. Have you any comment, Mr. Gilmour?

Mr. Gilmour: There were some statements made by the Minister of Finance to the Commons committee in the very early stages, but they were not concrete statements. There was the suggestion that this five-year revaluation might be reviewed, but no one has been able to pin that down.

Senator Croll: As a matter of fact, we have not been able to pin anything down, have we?

Mr. Gilmour: Exactly.

The Chairman: That is what we are going to try to do.

Mr. Twaits: I should add that our submission has been based on the proposals originally contained in the White Paper, and necessarily so; and any revisions or changes that the Minister of Finance has proposed recently we would be prepared to comment on later if we felt it necessary.

Now, we are prepared to answer questions, Mr. Chairman, and if it would be of any help we are prepared to discuss the question, as we see it, of the effect on Imperial, and we would also be prepared to discuss the oil and gas depletion question.

The Chairman: I should like to make a suggestion to start the thing off. Could we have a clear-cut statement as to the effect on your operations of the present taxes that you face? I am thinking particularly of the effect of the depletion allowance. We will then go on from there to see how it is changed by the proposals in the White Paper.

Mr. Twaits: You will realize, sir, that we have a shareholders' meeting coming up in about a week's time, so I shall have to be rather careful in my comments.

In discussing Imperial's position I should note first of all that there is a very great difference between companies in this industry, with respect to both their tax positions and their earnings. I should also note that prior to the sixties the oil industry historically was able to generate a great deal of its capital needs—a high proportion of them—but that situation has changed drastically. It does not matter whether it is Imperial Oil or any other company, we are all short of capital. In the next few years we are going to require a very large amount of capital of all kinds for various purposes, as I noted in my opening statement. We shall require it not only to find oil but to maintain technological pace and deal with changes in marketing situations, and so on. Obviously, any net increase in effective taxes would increase the corporate tax load and thus reduce the net earnings, which would make the corporation a less attractive investment in the eyes of both the lenders and the shareholders.

Less attractive depletion allowances, and the suggested reduction in capital cost allowances, which are also important, would both have this effect. The integration proposal would make it most difficult and costly to finance Canadian corporations, or to obtain new financing, especially for the new and growing ones, and ones like Imperial Oil which are engaged in exploring for and developing natural resources. Their shares would be in disfavour as compared with the shares of companies whose shareholders get the maximum benefit from tax credit.

If, for instance, the proposals in the White Paper had been fully in force in 1969, our income tax on producing operations alone would have increased by 25 per cent, from $29 million to $37 million. To raise capital you obviously need to maintain investor confidence. You have got to maintain a posture

in the market of dividend performance and so on in order to maintain your credit. Thus we would simply be forced to reduce our exploration effort. That would be the first thing. Of course, any removal or elimination of capital cost allowance would have the same effect with respect to physical plant.

Another factor would be that if for any reason we had to sell a major pipeline interest, or our holdings in major pipelines, the capital gains tax proposals would affect us seriously. If we were responsible for the quinquennial tax imposed on Standard Oil Company of New Jersey, which I mentioned a few minutes ago, I do not see how we could finance it.

Also important is the training and use of highly-skilled employees who, in our view, require international transfers for both the short and long run. This would be made almost impossible in our view by the higher taxes proposed for middle-income groups, and the severe aspects of the capital gains tax proposals. The partial inclusion, for instance, of personal residences, the full inclusion of vacation homes and other personal assets, the quinquenial tax on unrealized gains in the shares of public companies, would all make it very difficult to move people, to train them, and to give them world experience.

The quinquennial tax in our case would cause an unusual problem for our employees by reason of their holdings in Imperial shares through our long established savings plan. The plan provides that shares in our company purchased by employee contributions are held for the employee as a saving until death or termination of employment. Realizing the cash to pay the tax on these would, of course, be a very difficult problem for the employee.

Senator Croll: You started out by speaking about depletion, and I thought you were going to say to us: This is the law now, and this is what it costs us; this is the change in the law, and this is what it is likely to cost us. Have you any figures in front of you?

Mr. Twaits: I think we can provide that.

Senator Croll: I do not want to interfere with your statement, but...

Mr. Twaits: The increase, Senator Croll, is from $29 million to $37 million.

Senator Croll: Yes, but does that figure represent the difference between what is and what is likely to be?

Mr. Twaits: That is right, that represents the difference between the existing and the proposed. What we are also saying, senator, is that the existing depletion figure is not competitive with that in the United States.

Senator Croll: But that has been there for some time.

Mr. Twaits: It has been, but it is...

Senator Croll: You have lived with it—and very well too.

Mr. Twaits: Well, it has not always been so.

Senator Connolly (Ottawa West): You said the increase would be from $29 million to $37 million?

Mr. Twaits: Yes, sir.

Senator Connolly (Ottawa West): What percentage of increase is that?

Mr. Twaits: It is 25 per cent.

Senator Connolly (Ottawa West): And your present rate of tax is...

The Chairman: This is a combination of all the various taxes that they pay.

Senator Connolly (Ottawa West): Provincial and federal?

Mr. Twaits: The $29 million is our tax on producing profits only. It is not the total tax that we pay.

Senator Connolly (Ottawa West): That is the amount within a given year?

Mr. Twaits: Yes.

Senator Connolly (Ottawa West): I was provided with a copy of your annual statement yesterday, and perhaps I should have brought it with me this morning. You pay a certain level of tax, both provincial and federal?

Mr. Twaits: Yes.

Senator Connolly (Ottawa West): But this is relieved a bit by reason of the depletion allowance. What percentage of tax do you pay now? Are you in the 50 per cent bracket or the 60 per cent bracket, and do you go from the 40 to 60 per cent bracket to the 50 to 70 per cent bracket, or whatever the case may be?

Mr. Twaits: Senator, let me make it clear to start with, that we were talking about

effective depletion at the beginning, and not the total corporate tax load. Our tax in that sense on our producing operations, and calculating it for 1969, will increase from $29 million to $37 million which is, as I said, an increase of 25 per cent.

Senator Hollett: Would you speak a little louder?

Mr. Twaits: I am sorry, sir. Let me repeat and emphasize the figure we are talking about. In response to Senator Croll's question as to the effect of depletion I said that depletion affects only the profits relating to the producing operation—the production of gas and oil. Our calculation shows that in 1969, had the White Paper's definition of one-third of eligible expenditures as limited by one-third of net been in force, our tax on the producing operations would have increased from $29 million to $37 million, or by 25 per cent.

Senator Everett: Are you assuming in that, sir, that the taxes that are in force are post-1975 taxes?

Mr. Twaits: That is right, this is the post-transition phase, because that is what you have ultimately got to look at.

To get back to your question, sir, I cannot quite relate that to our total tax. I do not know whether Mr. Ewens can do that or not, or whether we can provide subsequent figures on it.

Mr. S. E. Ewens, Manager, Tax Department, Imperial Oil Limited: We have a figure which would include all forms of tax—corporation income tax, federal and provincial, the payments we make in the way of Crown royalties, and the payments to the Crown in the nature of bonuses for the acquisition of petroleum and natural leases. When we calculate all our taxes and all these other payments, our tax rate would be 61 per cent.

Senator Connolly (Ottawa West): That is under these proposals?

Mr. Ewens: No, that is today.

The Chairman: That is the existing tax rate?

Mr. Ewens: Yes.

Senator Connolly (Ottawa West): Do you pay mining tax in the province, or just is it just royalties?

Mr. Ewens: Royalties.

Mr. Twaits: We do not have a mining tax *per se*, but I used the term "pseudo tax" in my introduction. This is something that is quite unusual, but I think you are familiar with what I mean. I am referring to the various forms of regulations and so on that constitute a tax.

Senator Connolly (Ottawa West): So, your present rate is 61 per cent. Under the new proposals it would rise to a figure of...

Mr. Ewens: On our producing operations, as Mr. Twaits has said, it would increase by 25 per cent. I have not got figures but it would be something less than 25 per cent on a total basis.

The Chairman: Senator, you have been referring to 51 per cent and 61 per cent. Which is the figure?

Senator Connolly (Ottawa West): Sixty-one per cent is the effective rate of tax now.

Mr. Twaits: That is right.

Senator Connolly (Ottawa West): What I am concerned about is what the effective rate of tax would be if the proposals were implemented. The reason is simply this: if this rate goes up appreciably then the competitive position of a company such as this would obviously be very seriously affected.

Mr. Twaits: I wish we could answer your question. We can answer as to the effect of depletion, but the total package of the tax proposals as they would increase our tax load is impossible to calculate because of unrealized gains and other factors in connection with it. I regard, for instance, the integration concept and the two and one-half shelf life as an almost impossible planning program for an organization that has to raise money regularly.

Senator Connolly (Ottawa West): I was restricting myself to Senator Croll's question, because the increase in the effective rate and its effect on your competitive position concerned me.

Senator Laird: In connection with depletion, how much of your exploration and production is done abroad?

Mr. Twaits: None at the moment, sir. We used to have very extensive operations in South America. They were sold off in order to

finance western Canada. Our entire exploration program today is in Canada, or its frontiers at least.

Senator Laird: If the White Paper proposals were implemented would you consider carrying out foreign exploration and production?

Mr. Twaits: No, I do not think our position would make foreign exploration any more attractive. There are prospects in this country that are very attractive to explore. Two factors are necessary for exploration: good geological prospects and people. People is the answer to it. Also necessary are large amounts of money and the expectations of markets. We think Canada has excellent prospects if we are in a position to finance them.

Senator Laird: Yes, but I am indicating that if the White Paper proposals were implemented and you lost the present advantage with respect to depletion you would have to cut down on your exploration and production here. You have to produce in order to sell eventually at retail.

Mr. Twaits: I think there is probably a misunderstanding about this. We cannot produce our own crude oil, run it in our own refineries and sell it. It is prorated crude oil.

Senator Laird: But in some way it has to find its way to the retail market. It has to go through you or you do not make money.

Mr. Twaits: That is right. First of all there is nothing in the White Paper that would make us go abroad any more than stay here. Our financial position is the same. Secondly, if we reduce our exploration I feel sure that some foreign-based company would pick it up. That is the competitive disadvantage we are considering.

Senator Laird: Why would they pick it up here if the tax disadvantage is as bad as you say?

Mr. Twaits: Because they operate under their own domestic tax system.

Senator Connolly (Ottawa West): It is curious to hear you say that. In the early stages of our sittings the representatives of Noranda Mines Limited said, "We will not go away mad; we will just go away. We have prospects for minerals in which we are interested in other coutries where there are tax advantages. We would put our capital there rather than pay the high rates here, which make us non-competitive in our product." That does not apply to you.

Mr. Twaits: I am not familiar with Noranda's submission, but I would like to speak on it. In the first place I think the position of mining companies such as that from the point of view of internal cash generation is quite different from ours. Secondly, we should note a really striking difference between these two interests in the ratio of exploration expense to development expense. We spend far more money relatively in exploration and less in development. Therefore it is easy to go abroad and explore in the mining context in relation to the financial commitment. That is primary exploration. You can play around existing plays. For example, we have been on the Arctic coast for seven years. You do not go into this kind of project unless you can plan for a 10-year period. You have to organize yourself with respect to people and money. That is the name of the game.

The Chairman: Yes, and there is the point, Mr. Twaits, that having embarked on such a program under an existing law, then to have changes made while you are playing the game has serious implications.

Mr. Twaits: Mr. Ewens could offer a fuller explanation of our views on the subject of depletion, because there is a very serious retroactive feature.

The Chairman: Let us first of all have a clear statement as to what the depletion is now and what effect it has. Secondly, we would like to hear what will be the results of the proposed changes.

Mr. Ewens: In his opening remarks Mr. Twaits stated that we are recommending a depletion allowance for the petroleum industry which would be calculated as a percentage of gross income from production at a rate at least competitive with the current United States rate, and including an appropriate limitation based on net income from production. Under present tax legislation depletion is equal to one-third of a company's net profits from the production of oil and natural gas.

Mr. Twaits: Please slow down. I hope everybody understands the existing law, which means that every dollar of exploration that we spend—depletion is supposed to be an incentive—reduces our net profit from producing operations. Therefore it costs us in a sense 67 cents in the dollar to explore. This has been an anomaly in this tax legislation for years.

Senator Everett: Can you tell me how far ahead you can carry that?

Mr. E. D. K. Martin (Assistant Manager, Tax Department, Imperial Oil Limited): You cannot carry it ahead at all. It is current.

Senator Everett: It is only allowed on the earned income after exploration costs.

Mr. Ewens: Yes.

Mr. Twaits: Depletion rewards only the successful, not the unsuccessful. I think this is a very important principle, because the White Paper proposes to reward unsuccessful exploration over a period of time.

Mr. Ewens: As Mr. Twaits was saying, the present tax legislation produces the incongruous result that the more a company spends on exploration the less depletion it receives. As the White Paper says, "exploration costs reduce the depletion allowance" and "an operator of a mineral resource can logically claim he is inhibited from engaging in an exploration by the rules concerning depletion." Despite the admission that the present system acts as a disincentive to exploration, the White Paper proposes to continue the very same formula. The logic of this conclusion is very difficult for us to understand.

We have urged that the disadvantage of the present allowance would be overcome by adopting an allowance based on gross producing income, and at a rate at least competitive with current United States rates, limited to an appropriate percentage of net producing profits before deducting exploration expenses. We are convinced that gross depletion would be a much more efficient system of providing exploration incentive, and our reasons may be summarized as follows:

(1) The ability of Canadian companies to compete with Canadian branches of United States corporations would be improved.

(2) The depletion penalty imposed on exploration expenditures under the present system will be eliminated.

(3) The benefits now accruing to operators whose exploration program is small in relation to their profits from production will be reduced.

(4) An efficient incentive for risk-taking should reward success and not mere spending. Gross depletion achieves this objective.

(5) After full discussion over an extended period the United States has retained the system of gross depletion. The current rate in that country is 22 per cent for oil and gas.

(6) The United States Treasury considered the earned depletion concept proposal in the White Paper, which they refer to as the "plough-back theory", but did not accept it, or even recommend its adoption.

(7) Gross depletion recognizes the wasting nature of the asset being produced, a factor completely ignored by the White Paper proposals.

To us, perhaps the most disturbing feature of the White Paper proposals is the drastically higher tax burden that will be placed on income from past investments. These investments were made on an assumption that, if successful, the present depletion allowance would be deductible in determining taxable income. If the White Paper is fully implemented, the tax on income from prior investments would, after 1975, increase by 50 per cent. This would be a severe case of effective retroactive taxation. The rate of increase in taxation would...

The Chairman: Would you just stop there a minute and develop how you come to the conclusion that by 1975, with the establishment of the full plan of the White Paper proposals, your rates would go up by 50 per cent?

Mr. Ewens: Mr. Chairman, today the income from production is taxed effectively at $33\frac{1}{3}$ per cent. The income from present production after the White Paper system was fully in force, the income from present resources, would be taxed at a 50 per cent rate, which is a 50 per cent increase over the $33\frac{1}{3}$ per cent.

The Chairman: It is the difference between $33\frac{1}{3}$ per cent and 50 per cent?

Mr. Ewens: That is right.

Mr. Twaits: This is in response to your question, Mr. Chairman, as to the retroactive nature of spending your money on a different concept.

Mr. Ewens: The rate of increase in taxation would differ for each company, and could range from zero in the case of companies which never achieved a taxable position to 50 per cent for companies which, for one reason or another, did not continue to explore. Imperial Oil, as Mr. Twaits said earlier, if the White Paper proposals had been fully in force during 1969, the income taxes paid on produc-

ing income would have increased by $7.6 million, or more than 25 per cent.

The White Paper recognizes the tax impact on past investments and proposes a five-year transition period. In our opinion, this is grossly inadequate. The pay out on oil and gas investments is a very lengthy proposition. A normal exploration cycle covers five to ten years. Delineation of development consumes an additional one to five years before any revenue is received. Revenue from production is normally distributed over a 30-year period. The choice of a five-year transition period appears to be an accidental selection, coinciding with other admittedly arbitrary transitional periods and unrelated to the situation of the oil and gas industry. If the White Paper limitation of $1 of depletion for each $3 of eligible expenditures is adopted, despite our strong objections, we recommend that the transition period for the depletion allowance be at least ten years.

The Chairman: You are moving to another phase of this. There have been three different expressions used in relation to depletion: that is, 33⅓ per cent on the net production income, 33⅓ per cent on gross, and then talking about 33⅓ per cent on eligible expenditures.

Mr. Twaits: Mr. Chairman, let me answer that. I think we had better get these all in order on the terminology we use. The present system is 33⅓ per cent of net income from producing operations. That is net income after deduction of exploration expense from producing operations. The proposed White Paper is "the lesser of"; the present 33⅓ per cent of net income or 33⅓ per cent of eligible expenditures, let us just say exploration expenditures. There are some technicalities in that, but it is "the lesser of". "The lesser of" is the calculation that we have shown here would increase taxes by 25 per cent.

What we are proposing here is that we use the term 20 per cent of gross income. We say that if you want a true incentive for exploration you should follow and be competitive, semi-competitive anyway, with the United States, and grant depletion on gross income before the deduction of exploration expenses, but with a limitation in there that you cannot, of course, exceed probably 50 per cent of net.

Senator Burchill: Is that the method employed in the United States?

Mr. Twaits: That is right. This subject has been through 18 months of very intensive review there, and the White Paper proposal was considered but rejected. They retained the gross depletion system, reduced it slightly, and it is now 22 per cent. What we are saying is that we should have something competitive at 20 per cent.

Senator Everett: What is the appropriate percentage of net producing profits that you put as maximum depletion?

Mr. Twaits: You mean when we are talking about the limit if we use gross?

Senator Everett: Yes.

Mr. Twaits: I think 50 per cent of net, limited by 50 per cent of net. I should explain that in actual practice, from data we gathered from the United States, most people over a period of time get substantially the gross figure, probably 90 per cent anyway, between 90 and 95. So the so-called limitation of 50 per cent net is not usually too severe.

The Chairman: You do not hit the ceiling?

Mr. Twaits: That is right. Expressed in other terms, if you had 22 per cent gross depletion in the United States today, probably on average people would be getting an effective, let us say 20 per cent instead of 22 per cent. You get into some hairy calculations here on eligible expenditures and so on.

Senator Everett: Perhaps you could explain, then, what you mean in item (c) on page 57:

> The more efficient system we recommend would:—
>
> Reduce the depletion allowance benefits accruing to operators whose exploration program is small in relation to their profits from production.

Mr. Twaits: I think that is very simple. What it says is that this encourages more exploration, it encourages you to spend a greater portion of your money on exploration because you are not penalized by spending that money. We have stated it in reverse English here.

Senator Everett: Let us put the case where you have a small operator...

Mr. Twaits: This is not a small operator.

Senator Everett: I am sorry, an operator. Let us take the case of an operator who is deriving income and he decides not to

explore. Under the gross system he would get his full depletion allowance, and it would not be affected by the amount, as I understand it, of what he proposes to expend on exploration.

Mr. Ewens: Our answer to the specific question you have raised would be if a company had $100.00 of gross income from production and $10.00 of expenses for a net income of $90.00, under the present system $33\frac{1}{3}$ per cent of his net income would give him $30.00 of depletion. We are saying that if instead of the present system, he had a depletion allowance based on gross producing income of 20 per cent, his depletion allowance would be $20.00 instead of $30.00. This is for the type of company which does no exploring or spends very little of its gross revenue. This type of allowance would tend to reduce the benefit which the company now enjoys.

Mr. Twaits: You have asked a very critical question. Is that answer satisfactory?

The Chairman: Could we shake it up a little more, please.

Mr. Twaits: We are talking about the percentage of a company's producing income that it plows back in the form of exploration. What in effect Mr. Ewens is saying, is that the operator does not choose to explore very much today because he is penalized at 67 cents on the dollar for exploring. Under the present system he would, on $100. of net income, get $30.00 of depletion. Under our proposal he would only get $20.00. We think that is imminently correct, because the man who spends less on exploration would get less depletion.

Senator Everett: That is because the gross rate is less than the net rate? As I understand it the White Paper proposals are even more effective against that particular man who chooses not to spend money on exploration. It would seem to me that if a producer under the gross depletion system derives $100 of income from production and chooses not to spend any money on exploration he would enjoy a depletion under your system of 20 or 22 per cent, whatever that rate is, whereas under the White Paper system he would enjoy no depletion at all.

Mr. Twaits: The first comment I wish to make is that this depends on whether you are in a taxable position or not. In our case the proposal of the White Paper is a very substantial increase in taxation. It is a definite deterrent to exploration. In other words, a man who is not in a taxable income could look at this and carry it forward for many years with the hope that he will get it back. I do not think, overall, that this necessarily accomplishes the purposes which you are trying to achieve.

Senator Everett: I rather agree with your suggestion it is a sound one. I would not have used item (c) as an argument for it, however.

Senator Hays: Are you saying, in so far as depletion is concerned, that sometimes you are pushed into spending money unwisely?

Mr. Twaits: No sir.

Senator Hayes: Do you take full advantage of it?

Mr. Twaits: As I mentioned a few moments ago, you need prospects, people, money and markets. Nobody is just going to waste money on exploration, because no one has that kind of money. If, as the White Paper and everyone else recognizes, you want an incentive for mining and oil, examples can be found throughout the entire tax structure.

Senator Hays: You have taken full advantage of the depletion?

Mr. Twaits: We take full advantage of any taxes.

Senator Hayes: I realize that, but I cannot understand that you are the first group before any Senate committee which advocates making the tax structure a little broader. Why did you not suggest it a long time ago?

Mr. Twaits: We have been suggesting this for twenty-odd years to the Department of Finance.

Senator Hays: How does this affect the small operator?

Mr. Twaits: This would be applicable if you are in a taxable position now. I assume that the federal treasury would like to see all of the oil industry in a taxable position. That is the name of the game. As a matter of fact, every industry wants to be in a taxable position, because this means they are earning money.

Senator Everett: On this point, Mr. Twaits, on page 61 of the brief you indicate by your table that in order to enjoy the benefits under the White Paper which you are enjoying today in respect to depletion, a company would have to expend 150 per cent of its

income before taxes. Could you tell me what portion, in your last fiscal year, that Imperial Oil spent on exploration of its net income before taxes?

Mr. Twaits: This is net income from producing operations.

Senator Everett: That is fair enough.

Mr. Ewens: I cannot answer that question.

Mr. Twaits: We have been spending on the average about $30 million a year on exploration. To relate that to net income is more difficult. We do not look at it quite that way each month when we are reviewing our operations. We will get that figure for you and give it to Mr. Gilmour.

The Chairman: At this stage it might be helpful to have our consultant give a bird's-eye view of this position tax-wise and then we can see whether our concept of it is in line with what your views are.

Mr. Arthur W. Gilmour, Senior Tax Advisor: Gentlemen, under our existing Income Tax Act the way exploration and depletion works in computing taxes is this: any oil company that spends money on exploration or development is allowed to accumulate the expenditures on exploration. It must then apply, out of this accumulated sum, an amount each year that is sufficient to eliminate the production income for that year. In other words, if I assume the production income is a constant of 100 and if your accumulated exploration expenses were, say, 1,000 then each year you can use the 1,000 to eliminate the 100 for the year. You cannot use more than the 100 in any year to produce a loss that is carried forward. You merely can eliminate each year's production income. Then, once you have used your exploration expenses to eliminate the annual production income, so that you have a net amount of production income left, then you are entitled to claim a depletion allowance of 33⅓ per cent of that net figure.

In other words, once you go into a taxable position by having no more exploration expenditures to apply, then you can reduce the taxable income by 33⅓ per cent. So you are in the position today in Canada that many companies spend most of their income in exploring and proving of further reserves. The result is that they do not pay tax and of course they are also denied any depletion allowance. So we have today in Canada the fact that there are relatively few oil companies in a taxable position. Consequently, there are relatively few oil companies which are able to benefit from the depletion allowance.

The White Paper has proposed that we change quite drastically our present position. The White Paper in effect says, when you spend money for exploration or development the amount you spend is still a deduction that can be accumulated and used to level off annual income. But then, in addition to that, you get a so-called earned depletion equal to one-third of the sums you spent on exploration. That one-third can be saved and when you run out of exploration expenses you then start to draw on this one-third of your expenditures.

Once you have used up your full exploration expense and this additional one-third, then there will be no further depletion. This will mean that, when that day of reckoning comes, if the White White Paper proposal is adopted, then of course every oil company that comes into a taxable position is going to suffer a severe increase in its tax.

Those are the two contrasts as they exist between our present system and our White Paper proposal.

My understanding of the explanation of these gentlemen to my right is that they are seeking a practical extension of our present position, rather than a modification, if you like, of the White Paper. And that the proposal that they are suggesting is, continue to allow depletion on a percentage basis of gross income, which is what we allow. We allow today a 33⅓ per cent of net income. They are suggesting the American system—which has worked well—of a gross...

The Chairman: A rate reduction.

Mr. Gilmour: Yes, a limitation of that, so that in theory, under our present system, you could have an oil company that is producing and not exploring, not spending a penny on exploration, and has used up all its old exploration, and that particular company, if it had a constant income of 100, would be entitled to 33⅓ per cent depletion allowance to infinity, or at least during the life of the properties.

That may be in theory, anyhow, an unreasonable amount. So these gentlemen are suggesting a practical limitation of our present system, along the lines, approaching the United States system—which, as I say, has probably been the most experienced in the world and seems to work well.

The Chairman: Mr. Gilmour, what they are proposing, as I understand it, is that the principle which is applied in the United States is the one that they are recommending. They are only suggesting that the rate be less.

Mr. Gilmour: Yes.

The Chairman: Is there anything that your panel would like to add to this discussion?

Mr. Twaits: Yes, I think we might like to add a word on the 150 per cent.

Mr. Ewens: I might add a word of comment. As Mr. Gilmour has been saying, the White Paper really proposes imposing two limitations on depletion. The first could not exceed the present one-third of net present producing profits and therefore the proposal in the White Paper could not improve the position of anyone in the industry. Secondly, it would be restricted to one-third of eligible expenditures. As shown on page 60 of the brief, this would have the effect of penalizing those who spend less than 150 per cent of net profit after tax on exploration. We believe this is an unreasonably high level of exploration to impose on the industry. In other words, we think it sets far too high a penalty point.

The Chairman: Can you give an example?

Mr. Ewens: If you would look at the table on page 60 of the brief. If you like, I would be glad to run through this table with you.

The Chairman: This is important. We should clarify it.

Mr. Ewens: I would suggest that we look at the final column, that is, the one headed 150 per cent.

The Chairman: Yes.

Mr. Ewens: You will notice the first line showing profits before eligible expenditures of $6,000; eligible expenditures of $3,000; leaving profits after eligible expenditures of $3,000; and under the White Paper proposal, the depletion would be the lesser of one-third of eligible expenditures or one-third of profits after deducting eligible expenditures. In this particular example—one-third of 3,000 in either case. So the depletion would be $1,000, the taxable income $2,000, the income tax $1,000, and the net profit after tax, $2,000. To show the effect of this 150 per cent that we are talking about, if you move to the column to the immediate left, headed 100 per cent, and if we follow down again, we start with $6,000 of profits again, this time showing eligible expenditures $2,250, leaving profits after those expenditures, $3,750. Now, when we calculate the depletion, we again have to take the lesser of one-third of eligible expenditures or one-third of profits after deducting those expenditures, and the limitation in this case would be one-third of the eligible expenditures of $2,250, meaning that the depletion allowance would be $750, leaving the taxable income of $3,000, income tax, $1,500, net profit, $2,250.

If you follow immediately below that, you will see that the depletion under the present system would be $1,250. So the White Paper would produce a reduction of $500 in depletion.

So we are maintaining that, as soon as you move below the point where you are spending 150 per cent of your net profit after tax on exploration, you start to receive a reduction in depletion as compared with the present system.

If you move completely over to the first column in the table, you will see that you lose your depletion allowance entirely.

The Chairman: What you are saying is that to get the benefit of the White Paper you have to increase your expenditures. If you want to get the full benefit of the third, of the net; in other words, if you want to hit the ceiling.

Mr. Ewens: That is right, sir.

Mr. Twaits: This is a kind of *reductio ad absurdum*. No company can continue to spend 150 per cent of its net income on exploration. What we are saying is that to equate the present system with the White Paper you have to reach the absurdity that you would have to spend 150 per cent of your net income. Nobody can finance that kind of money.

The Chairman: What you are saying is that the ceiling doesn't mean anything.

Senator Everett: On page 61 there is a statement to the effect that one of the concerns of the Government was that the 50 per cent costs could lead to an abuse of intercompany trading of these rights. Could you tell me how that is done?

Mr. Ewens: We merely assume that because the White Paper does not permit the acquisition cost for petroleum and natural gas rights to be an eligible expenditure that the Govern-

ment must have been concerned that two arm's length companies in the oil business might sell rights back and forth to one another just to try to increase eligible expenditures. We are saying here that that could be easily controlled by only permitting as eligible expenditures the payments made to acquire petroleum and natural gas rights from the Crown.

Senator Everett: How could the selling back and forth between two companies at arm's length create an eligible expenditure?

Mr. Ewens: Let us assume that there were two equally valuable petroleum and natural gas rights held by two separate companies and each agreed to sell to the other for a million dollars. Each company would then increase its eligible expenditures by $1 million.

Senator Everett: I thought those were not deductible. I thought they were not classed as eligible expenditures.

Mr. Twaits: No, they are not.

Mr. Ewens: They are not, sir, and we assume that the Government, as a matter of policy, decided they should not be, because they were afraid this kind of trading would go on. But we say that that could be controlled by limiting it to Crown acquisitions.

The Chairman: And what you are saying is that they should be included.

Mr. Twaits: They should be. They are basic exploration.

The Chairman: I wonder if you would comment on your suggestion. You say "if", and I add the words by any chance, "the White Paper concept of depletion is adopted it should provide at least $1 depletion for each $2 of eligible expenditures". Now, what the White Paper proposes is $1 for every $3. What is your thinking behind that?

Mr. Ewens: As we show on the table on page 61 of our brief, the $1 for every $2 of eligible expenditures would have the result of not creating a penalty providing you spend 100 per cent of your net profit after taxes, and we say that going beyond that is unreasonable.

The Chairman: Well, isn't even going to 100 per cent, say, a fictional sort of thing?

Mr. Twaits: It is. We are not recommending this, Mr. Chairman. We are simply saying that even if you went to the $1 for $2, it does not answer the question, in our view.

The Chairman: I wonder if it is clear that, while you explore what the effect of this would be on $1 for every $2 spent, it is not a practical solution to the problem. I think we should emphasize that. You cannot assume that companies are going to spend 100 per cent of their producing income.

Now, Mr. Twaits, earlier you were speaking about your competitive position. Your company is in the export market as well as in the Canadian market, isn't it? Would you care to comment on what competition is presented by reason of that situation?

Mr. Twaits: Primarily, in the sense we have been talking about, it is competition for resource development. In other words, as is well known, the prospects are very bright in the future for larger markets in the United States, particularly for crude oil, and here are other products that we export, of course, and in our case we are competing with various sources of supply. The fact that there is a large market for Canadian crude oil in the United States does not mean that the United States does not have alternative sources of supply or could not develop other sources of secondary energy in their own country. By analogy, I just point out that the present White Paper tax proposals would, in our view, just push any possibilities of tar sand, or other secondary development, away down the road, because you cannot economically develop them. We are saying we want to be in a competitive position to develop supplies of crude and market them not only in competition with people in the United States but with other operators in Canada.

The Chairman: Are you saying that, if the provisions of the White Paper were implemented in relation to oil and gas companies, this would have the effect of pushing back an indefinite distance, or time, the development of, say, the tar sands, because you could not, by reason of its cost, make that development and be competitive in the export market?

Mr. Twaits: That is right.

Senator Hollett: If the White Paper is implemented, what will be the effect of that upon your relationship with the consumer or with the person who uses your products? In other words, will the price go up?

Mr. Twaits: If the White Paper is implemented?

Senator Hollett: Yes.

Mr. Twaits: I cannot answer a question as to whether the price would go up because of the White Paper, senator. We never know what the price is going to be.

Senator Hollett: Why is your price so much higher than the price in the United States?

Mr. Twaits: Our prices are not higher than those in the United States, senator.

Senator Hollett: Oh, yes, they are.

Mr. Twaits: No, they are not.

The Chairman: They are not, senator. You are forgetting the provincial taxes and the size of the gallon.

Senator Hollett: Maybe that has something to do with it, but I think your prices must be a little bit higher.

Mr. Twaits: I would be quite happy to provide you with border point data right across the country, or any other data you wish, which will show you that, after you take off the provincial taxes and the federal taxes and make allowance for the size of the gallon, our prices are very competitive.

Senator Hollett: I would appreciate having those figures.

Mr. Twaits: We will present them to Mr. Gilmour later.

Senator Connolly (Ottawa West): Mr. Chairman, you were speaking to the point of depletion a moment ago in talking of the provisions of the White Paper, and I must say it is disturbing to hear the witnesses make statements to the effect that the provisions of the White Paper in respect of depletion would postpone indefinitely the exploitation of the tar sand deposits.

Mr. Twaits: As you know, senator, we have spent many millions of dollars over a period of years on tar sands. It is simply an economic problem. The problem is to develop a synthetic oil which is a replacement for natural crude oil—I will use that term—at a price that will compete with crude oil. Now, with the removal of the mining tax holiday and the reduction in depletion, we don't see any prospect at the present time that you could economically develop those reserves.

Senator Connolly (Ottawa West): And yet they are said to be the most extensive reserves of any deposits in the world.

Mr. Twaits: There is no question about the fact that they are the largest single deposit. But the size of reserves is not significant in this. What is significant is the producibility and the economic feasibility. You have to have a large scale production. I think that Great Canadian Oil Sands can comment on this much better.

Senator Connolly (Ottawa West): The fact is that others know that the reserves are there in the tar sands. The Russians for example—and I bring this up periodically, because I think it is important—but I had an opportunity to talk to the people in Russia in January and they spoke about the great prospects for petroleum and natural gas in the Arctic. Now I would like to find out from you and I would like the record to show from you what the general position is in respect of deposits in the Arctic and the situation with regard to resources in the Arctic. Have we begun to scrape the surface? Perhaps you might even relate it to the questions I asked about the tar sands, because there you have a known deposit that is going to be adversely affected, but what about the situation where the deposits are perhaps unknown?

The Chairman: You mean quantitatively unknown?

Senator Connolly (Ottawa West): Yes, because the Russian view expressed to us—to Senator Aird—was that where the structures are the same, you can expect the same kind of resources and they are tremendous.

Mr. Twaits: Senator, I would be very happy to talk to that question because I wanted to follow up the Chairman's question in this regard. Let me see if I can put it in proper context, and if I leave anything out my associates here can correct me. I think we must look at the total oil situation and the fact that there is lots of oil in the world, far more than there ever was before despite the enormous growth of energy demands. Some of it is unfortunately located in very difficult spots. Now we in North America happen to be very fortunate in having a highly industrialized society that has indigenous sources of oil as opposed to Japan which is entirely dependent upon imports and the United Kingdom which only has the North Sea. Now, 20 years ago we discovered a new oil province, as it is known, with the discoveries at Leduc. I think the history speaks for itself.

Now the outlook today for continental energy resources is directed to what we call

the frontier areas. These are the continental shelf, whether that be in the Gulf of Mexico or in California or in Canada's east coast or the north.

I would like to talk to both of these in three senses. First of all the potential of the Arctic, and because we talk too casually about the Arctic, I will divide it between the islands and the mainland. The potential of the north has been evident to us for a long time, but the question is one of timing. You always think there is oil in a prospective place, but you cannot afford to prove there is no oil. You have to do the type of exploration that will determine if there is going to be economic reserves, and this has been very clear for many years. The economics are simple, and that is you cannot find an oilfield of the size that you can commercially exploit in Alberta, and have it economic on the Arctic coast. The Arctic coast after all is 1,600 miles north of Edmonton through very difficult terrain and involves ecological problems. So you need to start with huge reserves. For 50 years our company has been operating in the north where we recognized the potential. But the thing that sparked greater activity was that after many years of very unsuccessful exploration in Alaska, there was the Prudhoe Bay discovery which was big enough to be commercially exploitable. Because of the published numbers, I think I should remind you that there will be expenditures in the order of $2 billion before 1 barrel of oil is produced at Prudhoe Bay, and this is simply to develop the field and get it out to tidewater. I have not included in that tankers or downstream investment. It is on this basis that the whole potential of the Arctic coast has suddenly expanded. Now that potential is not going to be developed unless we can get large reserves and unless we have the financibility and the capacity to develop the necessary logistic systems, whether pipelines—and a rough estimate of a pipeline from the Arctic coast through to Chicago is about $2 billion—or thereabouts.

So that is the size of the thing we are talking about. The oil has to be highly producible in large quantities from a single well and it has to reach the market in large quantities in order to be economic. Now, on the other side of the fence you have a different problem in the Arctic where you are dependent on the solution to water transportation. By that I mean the Arctic islands. There, no matter how geologically prospective it is, the logistics system show you only have one alternative. On Canada's east coast there are hundreds of millions of acres under active exploration, and that is also geologically prospective but it also has a different kind of problem and that is underwater technology. The oil industry is betting that by the time we find something commercial out there, we will have the technology to do it. Now all of this requires financibility and the money. It requires looking ahead ten years, and this brings out an important point that I want to make with you, Mr. Chairman, and that is that we are constantly in the industry under pressure to restore our reserve position all the time and we cannot, as in the mining industry, hold a mineral prospect, as we have one today, which is not commercially viable at the present time. We can wait for that mineral market, but you cannot wait in the oil business. You have a big and continuing exploration effort.

Is that a partial answer to your question, senator?

Senator Cononlly (Ottawa West): It is a good answer because I think the thing the committee must consider is the very broad picture of what Canadian prospects in this industry are, and a fatal step now in the tax field might very well inhibit the development we must have. I am pleased that your answer is on record.

The Chairman: Mr. Twaits, is it a published figure, the relationship of your export sales to total sales?

Mr. Twaits: There is no problem there; as a matter of fact, we have it in our annual report. There is a peculiar situation here. We of course took the leadership early in finding export markets for oil, but in 1969—and this is at page 24 of our annual report—we produced—that is our own company—154,000 barrels per day net production after royalties. We purchased from other producers 500,000 barrels per day. We are a crude buyer and seller; we market other people's crude. There are hundreds of producing companies in western Canada who do not have the necessary crude oil market and so we buy their crude. So our total supply of crude is 654,000 barrels a day and we sold to the domestic refiners 255,000 a day and to the export market we sold 162,000 barrels a day and we use in our own refineries 237,000 barrels a day.

Senator Hays: What percentage is that of the total amount?

Mr. Twaits: The total export sales? Last year the total industry exports—I should know these figures by heart—were 550,000 to 560,000 barrels a day. That is the industry export sales.

Senator Hays: I realize that, but what percentage?

Mr. Twaits: Let us say that our 162,000 barrels is about 30 per cent.

Senator Connolly (Ottawa West): That is the domestic market?

Mr. Twaits: No, the total export market, we sold about 30 per cent of that gross sale into exports.

The Chairman: And this is earning U.S. dollars to help our exchange position?

Mr. Twaits: Well, the United States situation brings it out; the balance of payments is quite an important figure because without Canadian crude production today you can generate figures that we would be $2 billion a year worse off on balance of payments, but that is almost a theoretical figure because I do not think we could be $2 billion a year worse off.

Senator Hays: No, but what percentage of the petroleum marketed in Canada do you enjoy?

Mr. Twaits: Are you thinking of what we sell?

Senator Hays: Yes.

Mr. Twaits: Well, our average market position is around 22 per cent, something like that. We are not nearly as big a per cent of the market as people think we are.

Senator Connolly (Ottawa West): Are you talking about at the retail outlet or the refining?

Mr. Twaits: That is our total product sale as a percentage of the total.

Senator Molson: But you import for your eastern refineries?

Mr. Twaits: Yes, we do, Senator Molson, and to give you the ratio there, I said we produced 154,000 barrels a day of our own crude. We utilized in our refineries 377,000 barrels a day of crude and imported the balance, which is 140,000 barrels. So we produced 154,000 barrels, we purchased 237,000 barrels of Canadian crude from other people, and we purchased another 140,000 barrels.

Senator Everett: Would you be able to tell us by what amount your reserves increased last year?

Mr. Twaits: That is in here some place. We make full disclosure! I am told it is on page 1.

Senator Everett: And early disclosure!

Mr. Twaits: Gross recoverable reserves—this is crude oil and natural gas liquids—was 1.7 billion at the end of 1969, as against 1.6 billion in 1968, so they rose by 100 million barrels. This is after production, of course.

Senator Everett: After production?

Mr. Twaits: Yes, these are net recoverable reserves, or rather gross remaining recoverable reserves before royalty.

Senator Everett: Do you disclose net income on the producing part of your business?

Mr. Twaits: No, we do not break it down because so many parts go back and forth that it is a very difficult thing for technical and accounting reasons. It can be broken down for tax purposes, but we do not disclose it.

Senator Everett: Do you have any idea of what the rough value of that increase in your reserves is?

Mr. Twaits: That is a very good question, sir, because it brings up what is a reserve worth. If that reserve is not going to be produced for 30 years down the road. And you have your money worth 8 to 10 per cent today, then these reserves are not going to be worth very much in the ground.

Senator Everett: Your point is well taken, but I wonder if you could now answer the question.

Mr. Twaits: Well, you cannot. That is why you do not evaluate reserves on a balance sheet; you do not know what they are worth.

Senator Hays: As anyone who has held a portfolio knows!

Senator Cook: Would there be any figures readily available showing what the oil industry as a whole contributes to taxation, say over a five-year period?

The Chairman: You mean the total oil industry?

Mr. Twaits: You mean the total revenues to governments generated by oil?

Senator Cook: Yes.

Mr. Twaits: They are staggering.

Senator Connolly (Ottawa West): I take it Senator Cook means the petroleum industry.

Senator Cook: Yes. In other words, what are we likely to be interfering with?

Mr. Twaits: Well, if we produce $4 of Government revenues for every dollar of net earnings, I doubt if that ratio would apply throughout the industry, but it is very high. This taxation begins from the time you take out an exploration permit and runs through the entire system, and so on.

The Chairman: Does this $4 include every type of tax?

Mr. Twaits: This includes all taxes. It includes the road taxes. The figures I quoted were our taxes, royalties chargeable against income last year, in excess of $149 million, as against our net earnings of less than $100 million. We collected in addition to that $233 million in consumption taxes and excise taxes.

Senator Everett: Of the accrued income tax of $50 million set up in 1969, could you tell us how much of that is deferred?

Mr. Twaits: Would you like to talk about how much of the accrued is deferred, Mr. Ewens or Mr. Martin?

M. Martin: It is about $20 million, senator. Let me give it to you more exactly: $21.5 million, senator.

Senator Everett: Of the $50 million accrued?

Mr. Martin: Yes.

Senator Molson: If we have dealt with the depletion subject, I wonder if we could ask Mr. Twaits to deal with the other recommendations in this brief?

The Chairman: Yes, I was just going to move into that area.

There was a preliminary question I thought we should put, because when the Noranda people were here they said that the lumping together of mining and oil and gas was an improper thing to do; it just did not fit in.

Mr. Twaits: That is correct.

The Chairman: I gather that you have said something like that here today.

Mr. Twaits: Yes, we have, sir.

Senator Molson: You returned the compliment!

Senator Hollett: Before we move on...

The Chairman: Could we get an answer to this question first?

Senator Hollett: Before we move on, I want to mention that I come from Newfoundland, where we were brought up on fish. I am wondering if the drilling for oil on the Grand Banks and around Labrador is not the beginning of the end for the fishery.

Mr. Twaits: Well, sir, I guess my most practical answer to your question is that the much publicized accident to the "Arrow" has resulted in not one whit of damage to commercial fishing in Chedabucto Bay.

Senator Hollett: That is not what I have heard.

Mr. Twaits: Well, that is the truth. I would refer you to the Department of Transport or Fisheries because they are very much on top of the situation.

Senator Hollett: I am a little worried and so are many other people, but if you people can handle it, so much the better.

Mr. Twaits: I would like to make it very clear that any place where you have industrialization, including the plants which you have on the Canso Straits, which were mostly put there with Government assistance, you are occasionally going to have some kind of an accident.

Senator Hollett: That is what I am worrying about.

Mr. Twaits: But you do not get rid of airplanes, because they have accidents. The industry is dedicated to keeping the water clean, and we have been doing it for many years. I can say that there will be no oil operations on the continental shelf in the east that do not have the most complete protection known.

The Chairman: Are we going to have your specific answer, Mr. Twaits?

Mr. Twaits: I pointed out in my introductory statement that we do not believe that the

mining and oil industries are in the same situation. Here today I have pointed out differences in respect to exploration, the ability to hold a property, the pressure for reserves, and so on. We deliberately did not highlight our point of view on minerals because we are minor in minerals, and we think that the mining industry is in a better position to do it.

The Chairman: And you did not want to say specifically that you did not like their company taxwise.

Mr. Twaits: The only thing that I did not enjoy about the Noranda brief was their reference to the oil industry. That is why I am not referring to the mining industry.

The Chairman: Can we move on to a question that was touched on earlier? At one stage, Mr. Twaits, you referred to the 2½-year limitation on the distribtuion of accumulated profits, and said that otherwise the benefits of the White Paper would be lost.

Mr. Twaits: Do you mean in connection with integration?

The Chairman: Yes, in connection with integration.

Mr. Twaits: I would like to have one of my associates talk to you for a minute about that. Would you like to speak on the integration aspect, Mr. Martin?

Mr. Martin: Well, the 2½-year shelf life problem arises if a company's taxes vary due to its claiming capital cost allowance. It has then to make its dividend policy go up and down to follow it. You see, you might have the case in some years where you have a heavy expansion and quite heavy capital cost allowance, and quite a lot of deferred income tax, and you would have to have your dividend policy follow your tax payments. This would put a lot of constraints on a company, because many companies wish to keep their dividends level. A great many people live off the dividends, and they cannot very well cut back on their food and rent just because a company is spending a lot of money on expansion in that year, and not paying so much income tax.

To the shareholder of a widely held company, the 2½-year shelf life could be a real headache, because either the rate of tax he pays on his dividends will vary up and down, or the amount of the dividends will vary up and down. I think any small investor will tell you that this is not how he can pay his bills.

Senator Laird: Have you any idea at all of the type of person who invests in your company, other than the one big investor that you mentioned. I know that Mr. Twaits gave a figure of so many thousands, and I have forgotten what it was. Have you any information as to the type of person who invests in your company?

Mr. Twaits: Yes, we have, senator. They range from the five-share person to institutions, but next to Bell Telephone we have more Canadian shareholders than any other Canadian company. If you put that in its proper perspective in relation to the United States market, it is the equivalent of having about 750,000 shareholders. That is a very wide distribution. There are very few companies in the United States that have 750,000 shareholders, except A. T. & T. or a company like that.

Senator Laird: There are many small shareholders?

Mr. Twaits: There are lots of small shareholders. One of the major reasons why we split our stock a year ago was to make it more accessible to the small investor, and it has worked out that way.

Senator Everett: Is your recommendation on the 2½-year rule one that will affect only widely-held corporations?

Mr. Twaits: I think I would like to expand on this subject a little bit, senator. Mr. Martin has given you the shareholders' difficulty, but let us look at it from the standpoint of a corporation that has to plan years ahead, is capital intensive, and which must plan its financing. I need hardly tell this group that you do not go to the market whenever you want to go to the market. You go to the market when it is appropriate, and so long as you have the confidence of the market. What really bothers me is that on the integration proposal—with the 2½-year shelf life—you are forced to pay out dividends. How do you plan any financial program? How do you plan on a proper balance between retention of earnings, debt, equity, and so on? Equity financing is extremely costly. We figure with the maximum debt-equity ratio our cost of financing is from 10 to 11 per cent, after tax. That is the cost of money to us. I am sure with other corporations it is substantially higher than that. So, under this concept, if you are push-

ing out dividends you are in one sense unable to guide your financial planning, and, in the other sense, you are relying more heavily on equity than you might wish to, and that is the most costly form of financing.

Senator Burchill: What percentage do you run at?

Mr. Twaits: We are not at any limit now, sir, but I do not think a triple-A corporation can have a debt-equity ratio that is much less than a 10 to 1 coverage of the debt interest. That is a rough index to get a triple-A rating.

The Chairman: Do you agree that to get the benefit of this 2½-year shelf life you are in a position where you have to pay out more in the way of dividends, and the effect of that from the point of view of the public might be that your stock would become even more attractive, although on the other hand your problem in respect of raising money would become more difficult?

Mr. Twaits: I am unable to see, being as unbiased as possible, why this would tend to improve or raise the price of any stock. There are too many other factors involved in it. People buy stock for a variety of reasons.

The Chairman: And sometimes without reason.

Mr. Twaits: Yes. Leaving aside the speculative nature of it and looking at the savings phase, integration to me is an undesirable concept as opposed to the dividend tax credit. The dividend tax credit is simple. It is an encouragement to save. Integration, first of all, moves the shareholder into a higher tax bracket even though it gives him back some money. Secondly, it is a very difficult thing to administer and handle. Thirdly, it puts this dividend pressure on both the shareholder and the company. Just adding it all up, and as our brief says, we are not in favour of integration. That is obvious. We do not think it has either shareholer or company advantages.

Mr. J. W. Hamilton, Director and Vice-President, Imperial Oil Limited: Mr. Chairman, I should like to add just a word to that. I think it has a particular impact in so far as resource industries are concerned, because what happens is that a resource industry has less creditable tax in so far as the shareholder is concerned and, therefore, the shares of a resource industry are not as palatable, shall we say, as those of a corporation which has a fully creditable tax. Therefore, to that extent the resource industries will suffer when it comes to their obtaining equity money.

Mr. Twaits: We have put a lot of emphasis on financing, but there are many other factors that we can mention here. Certainly we see that private companies would have an advantage over public companies. That is one. The inter-company dividend tax will worsen the position of many shareholders. It takes away at the shareholder level any tax relief that is given to the corporation. Individuals whose only source of income is dividends will receive tax refunds in many cases, and the more well to do will reduce their tax substantially, which seems to oppose the feature of equity which has been spoken about so much. I need hardly defend the problem of electric, gas, and steam utilities.

The Chairman: No, you do not need to.

Mr. Twaits: I think you have had that one. Finally, I should bring your attention to the fact that this scheme would bring strong pressures on Canada from other countries to extend the benefits of integration to non-resident investors. I presume, sir, that you are familiar with the French situation and what has happened there, where they have had to extend it.

The Chairman: I notice that in dealing with the French situation your brief suggests that France had originally limited the integration principle to the domestic area. However, by pressure from the U.S. they had been forced to extend it to the non-resident. My understanding of it is not complete. Your brief suggests that there is no limitation there, but my understanding is that there is some limitation to the percentage holding by the non-resident where integration would apply.

Mr. Martin: In the case of an American resident who is a portfolio investor of a French company 15 per cent is withheld from dividend cheques. The French Government issues an accompanying cheque for $50 less 15 per cent, or an additional $42.50. That is the corporation income tax which the French company has borne and which is paid to the American shareholder providing he owns less than 10 per cent. Should more than 10 per cent be owned, the withholding tax is reduced to 5 per cent. We think this would be an extremely expensive procedure for the Canadian treasury. It is clearly recognized by the Americans that the French semi-integra-

tion proposal was designed to give an incentive for the French investor to invest in France. By so doing it discriminated against the French investor investing outside France, and the non-resident investor investing in France. This is exactly what the White Paper proposes to do. The United States said that this is gross discrimination because if the local corporation tax is refunded to the shareholder in France, then the non-resident American shareholder should also receive it. I understand they took advantage of temporary French problems on balance of payments and said, "Now, fellows, what about giving us a square deal?"

The Chairman: This was the result of negotiation in order to conclude a tax treaty between France and the United States.

Mr. Martin: Yes sir.

The Chairman: It is not the local law in France.

Mr. Martin: No.

The Chairman: This is a tax treaty, which overrides the local law.

Mr. Martin: That is right.

Senator Cook: The same thing happened to us when we got over the barrel.

Mr. Martin: I think it could well happen. I have been asked on a number of occasions what is the difference between our present dividend credit system and the White Paper proposal on integration? Do they not both favour the domestic shareholder? Sure they do, but Uncle Sam seems to see a difference. He may say you are discriminating against the American investor. But I understand that question has never been raised. He can see the difference between the two; I cannot see it exactly. He is going to leave us alone with the 20 per cent dividend credit, but he goes after the French. I do not understand it, but "Vive la différence".

Mr. Twaits: This indicates that even within our delegation there are certain differences, because while Mr. Martin cannot see it, I see an enormous difference.

Mr. Chairman, you raised a question which embraces the whole question of tax agreements with other countries. This is where so many parts of the White Paper depend on coming to a logical agreement with someone else. However, other people are not nearly as logical as we are.

The Chairman: Mr. Gilmour may have a comment to make on what we have been discussing.

Mr. Gilmour: Gentlemen, this is with reference to the requirement to pay out dividends within a two and one-half year period. As members of the committee know, the White Paper proposal on integration has been lifted almost without change from the now discarded British system which was invented in the year of one. Under this system they passed on to shareholders the standard corporation tax that had been paid by corporations. Of course, the reason given by the British in 1965 when they abandoned this system was primarily to prepare themselves for entry into the European common market and to develop a system with which international investors were familiar. Secondly, it was to put some reason and realism, as they said, into their tax system. It is amusing in looking back at the English experience to see that their original system was for a corporation to pay what was known as the standard rate of tax, which was passed on to the British shareholders as tax paid in advance. Then, of course, the strains of wartime finance required additional funds and the British introduced the profits tax. Because of the clamour of shareholders to get the dividends on which tax had already been paid, the British did not introduce a two and one-half year period. Instead they brought in legislation that would reduce the profits tax if earnings were retained within a company. Therefore the British, after years of experience with this integration system that we are blithely proposing to adopt, found that it caused companies to distribute so much of their profits that they could not expand. As a result of this what was in effect a tax incentive had to be granted to keep the profits within the company.

Senator Connolly (Ottawa West): I take it the argument is much more cogent when it comes to the development of resource industries as opposed to others.

Mr. Twaits: I think Mr. Gilmour has brought out a very important point. Another significant feature is that we are at already substantially higher corporate levels of income tax in this country than most other industrialized countries, so the integration proposal has an even worse impact here. Is that not right?

Mr. Gilmour: Yes. The British rate, as an example, is 45.

Mr. Twaits: And not very many are paying that.

Mr. Gilmour: No.

Senator Everett: Mr. Twaits, you make a very persuasive case in your brief and in your evidence for either 20 or 25 per cent tax dividend credit and no two and a half year pay-out. It seems to me that this case is particularly apt for widely-held corporations. Do you make the same case for closely-held corporations? If you do, can you tell me how you would equate the relief that is given to closely-held corporations by the White paper with the replacement of that relief of the 20 or 25 per cent tax dividend credit?

Mr. Twaits: I will start this off and then ask my associates to expand on it. I will first answer your second question. I simply do not understand the particular, shall I say, status accorded to the closely-held corporation. I think the essence of our brief is that we believe the tax system should be an incentive to entrepreneurial growth, and that includes privately held corporations and so on. But there are very many large closely-held corporations in this country and we cannot see that differential.

The dividend tax credit has, in my view, particular application to the widely-held corporation, simply because the widely-held corporation is a tradeable security, a marketable security, and a closely-held corporation is not necessarily so. I do not know whether my confrères want to expand on that.

Mr. Martin: The only expansion I would like to make is that we deliberately restricted our comments to the widely-held corporation because we do not hold ourselves out to be experts on closely-held corporations. It is obvious that in most cases the shareholder of a closely-held corporation would be better off with full integration than he would be today, because today you pay some tax if you are the shareholder of a closely-held corporation and get a dividend. In other words, under the full integration system proposed you would pay no tax and get a refund, so there is no doubt in my mind that sareholders of closely-held corporations will be better off under the White Paper than the situation with the 20 or 25 per cent tax dividend credit. I need not draw your attention to the possible inequities of shareholders of these companies paying no tax on their dividends. I believe that has already been drawn to your attention.

One thing I do wish to make very clear is that I do not think the distinction between widely-held and closely-held is really tenable. Pressure points develop in a tax system. One pressure point, of which we have heard a great deal, is the low rate for small business. We have had to have ministerial discretion to deal with that. Here you have far greater pressures to convert widely-held into closely-held. I know the White Paper says once you are widely-held you are always widely-held. But once the pressures are there to change it, what will happen is that some people who want their company changed will go to a lawyer or accountant and say, "Find me a way to do it, and if you cannot somebody else will." It is just the name of the game. A professional consultant will find a way if there is a big enough incentive to do it. I am sure this distinction will break down.

The second reason, which I object to very much is this idea that closely-held compete with closely-held and widely-held compete with widely-held. It is the most ridiculous thing I have heard. We compete in the oil business with people of all sizes, shapes and description.

The Chairman: All you have to do is look at Simpsons and Eatons.

Mr. Martin: Yes, sir.

Mr. Twaits: That is a good example.

Mr. Martin: This is why we did not go very deeply into the situation of the closely-held corporation. We do not hold ourselves out as experts on it.

The Chairman: What you are saying leads into the question of the position of small businesses, and you do make some comment on it. There has been more than a suggestion made that possibly one of the so-called virtues of the closely-held corporation provisions here was to try to work out some compensation to the small businesses. But there must be better ways of doing it than using an elephant to deal with a situation where you only have to make a contest with a fly.

Mr. Martin: That is right.

Mr. Twaits: Every big business was once a small business. I do not suppose you can defend a two-tier tax system from a technical or theoretical point of view, but we deal with thousands and thousands of small businesses,

and there are very practical problems here. We recommend very strongly that the present $35,000 limit be retained as a real entrepreneurial incentive.

Senator Molson: You have the graduated system as far as personal tax is concerned. Perhaps you could defend it to some extent for small businesses in that way.

Mr. Twaits: Of course, I do not subscribe to the view that the larger the business the higher the tax rates you pay.

Senator Molson: Neither do I.

The Chairman: I think this might be a good place for me to get Mr. Twaits' opinion. I have been discussing here and in various meetings dealing with small businesses the retention of the 21 per cent on the $35,000. It could be done very easily by defining what is a small business. It could be defined very readily by the net profits of the business. If a figure of, say, $100,000 were taken and it was said that a small business is a company whose earnings are not in excess of $100,000 a year, in those circumstances they would be entitled to get 21 per cent on the first $35,000. They pay 50 per cent the same as the general corporate rate on the other. Then to avoid the difficulty where the small business had $100,001 of income and therefore be disqualified, we might develop a notch system, that the 21 per cent goes up so many points for each $1,000 or $5,000 over $100,000. That would deal with the small business. I would say that at least 60 per cent of the representations that have been made to us, in letters and briefs, where people are not asking to appear, the issue of small businesses has been raised. We had the B.C. Forest Association here recently, who said that they are basically small businesses and are dependent for the capital for expansion on internally...

Mr. Twaits: Retained earnings.

The Chairman: By their own retained earnings they do not have the credit position in order to get money. They illustrated how that affected advances and their ability to produce competitively in the United States with their counterparts.

Mr. Twaits: Why have there been objections raised to the two tier system? Most of these have ben raised on the grounds that they provide loopholes.

The Chairman: That is not what Mr. Bryce said here when I put this question to him. He said it was offering a subsidy.

Senator Cook: You have answered that on page 49 of the brief:

> At $1 million of revenue the 53 per cent rate becomes 52 per cent when account is taken of the lower rate of tax on the first $35,000 and at $10 million it becomes a shade over 52.9 per cent.

In other words, the so-called gift of a lower rate to the large corporation is nothing.

The Chairman: I do not see any justification for extending the low rates to all corporations, but only to extend it to the ones that make a case for it. Those are the small businesses. How it developed into this concept I do not know.

Senator Connolly (Ottawa West): Mr. Chairman, I think probably Mr. Bryce's word was a badly chosen one. I do not know what he called it, but I do think that the two tier system is an incentive for a small business to become a larger one. I feel the formula you are talking about is one which would extentuate the pressure on the small business to become a large business without having too severe a tax load as it develops.

The Chairman: Yes.

Mr. Twaits: I have no criticism about the formula, sir. I just want to reiterate that there are many areas of enterprise that lend themselves to small businesses but they are never going to be a big businesses. They do have real financing problems, as well as working capital problems. Those of us in our type of corporation are dealing with them all the time. I agree with Senator Connolly that it is not a question of subsidy. The tax system is filled with subsidies, incentives and various gimmicks. You need that kind of an incentive, because it stimulates the entrepreneur. Frankly, I see nothing wrong with what is going on.

Senator Connolly (Ottawa West): It is this department of government that is dedicated to the principle of subsidies.

Senator Cook: How can you subsidize somebody with his own money?

Senator Connolly (Ottawa West): Let us remember a little piece of history. When industrialization of this country began it was

decided that the best way to do it was to provide tax incentives through the tax act and not set up special departments of government to spend public money, but to let the private entrepreneur take it over and do it in his way. The formula that the Chairman proposes here is simply one which seems to be very sound, because the management of the whole enterprise lies with the entrepreneur who is not going to spend a dollar unnecessarily.

Mr. Twaits: I agree with you. There is one point which we tried to make but did not expand too much. Regardless of small busines, one of the great competive factors world-wide in international trade today is tax systems. We, in North America are virtually the only island left which does not use value added or border taxes which gives the competitor in Europe an advantage. The tax system is not a private little arrangement within a country any more, but a real competitive tool world-wide.

Senator Connolly (Ottawa West): The more Canada is to develop the more she has got to be competitive.

Senator Hays: In your opinion, how would you define the small businessman? You said there are small businesses which will never become large ones.

Mr. Twaits: I mean particularly the service businesses, such as the service station. We cannot only have super cooky shops and super shoe shine shops, because they are not necessarily the most productive enterprises. There are lots of small businesses which are quite technological or otherwise. I do not know how I would define it. Senator Hays. We might be inclined to take a stab at it. I think there are lots of other people in small businesses who are perhaps better able to define it than I am.

The Chairman: Mr. Twaits, I am just wondering whether there are other points. We have exhausted the ones which we thought were not only important to your company, but your point of view on questions that are of general application. Are there any other headings that any member of the committee would like to raise? I will then ask Mr. Twaits if there is anything he wishes to add.

Senator Hays: I would like to raise one point. On page 20 of your brief you say:

> We have been informed that the White Paper has already retarded the pace of generation of capital and its implementation can only aggravate this retardation.

Do you have any examples?

Mr. Twaits: I do not have any specifically which I can quote. No one can be quoted on these things, but we do have internal examples. You gentlemen will appreciate that we are trying to make financial and operating plans for three to five years in advance. I defy you to come to a major investment decision today. You do not know what the ground rules are going to be.

Senator Hays: This is important. You make a statement, but it is not documented. I think this is what this exercise is all about.

Mr. Twaits: Let me put it this way: first of all, in our management today, and I am sure in that of other corporations, we find ourselves unable to—let me give you an example. Between conception and implementation of any major refinery construction which is, for instance going on all the time, you are always replacing something or producing an improved product. Between concept and implementation of substantial investment projects is three to four years. At Sarnia we have a major program in chemicals and refining that was conceived in 1964 and it is not finished yet. What our management says to us today is "What are the ground rules and how do we know whether this is financeable with the White Paper. How do we know what earnings position we will be in and how do we figure the economics and financing of those projects?" That is internally. Externally we have examples of people who are making decisions and making them for fear of the consequences of the White Paper. We have another outstanding example which we have already quoted and that is the decision with respect to the Athabasca tar sands. I must say that any of us today in industry are going on the basis or an assumption that the White Paper in its entirety could not be incorporated into this country at one fell swoop. It would be impossible.

The Chairman: When you say "one fell swoop" you really have to qualify that by saying in the norm and even having regard to the transitional provisions.

Mr. Twaits: That is right. No country has ever made wholesale tax reforms except over a period of many years and even if you look at that you will find that no one has ever really made wholesale tax reforms. Has any country ever achieved wholesale tax reforms?

Senator Cook: The Russians did, forty years ago.

Mr. Twaits: You have a choice between systems, senator.

Senator Hays: You seem to indicate that you are opposing a capital gains tax, yet at the same time you say that if you have to live with it, it should be 25 per cent. Why would you recommend a capital gains tax, why would you not oppose it?

Mr. Twaits: I am very glad you asked that question. We do not think that a capital gains tax is appropriate to a country that is capital short. We do not believe that.

On the other hand, to be realistic, one of the major problems in the present situation is that you have no definition of a capital gain. It is completely discretionary. What we are suggesting here, with phasing in, and so on, is that perhaps we do need a capital gains tax. We believe it should not be as high as 25 per cent. We believe it should be down in the order of 15 to 20 per cent. But we need to have something that is a definition, because the present system is intolerable, it is simply discretionary whether it is capital or an expense. Have I explained, gentlemen?

Senator Connolly (Ottawa West): Can we take this a step further? What is proposed of course is that the ceiling the 50 per cent, and let it be put on top of the income or gains tax. Is your argument also that it should be a separate act as it is included in the United States?

Mr. Martin: You would have to define them if they are taxed at a lower rate.

Mr. Twaits: I do not think I could answer that question from a legislative point of view, but I believe it has to be distinct and clear.

Senator Connolly (Ottawa West): In other words, not incorporated into the income tax of a given year?

Mr. Twaits: I do not think so. I do not know how my tax experts feel here. I think it has to be clearly defined, because definition has been a real problem.

Senator Hays: On your figure, the difference between $29 million and $37 million, taxes, which would be at 25 per cent increase, is there some of that that might have been capital gain?

Mr. Twaits: No. That is entirely the difference in the depletion regulations, it has nothing to do with any other part of the White Paper.

Senator Hays: If you had had to live with the 25 per cent capital gains tax, have you any studies as to how it would have affected your company?

Mr. Martin: It would have had very little effect. The capital gains tax would have had very little effect on us over the last ten years, because of the small proportion of capital gains in the profits reported to our shareholders.

Senator Hays: Is this peculiar, in your opinion, to most largely or widely held companies with capital gains, that it is not a serious thing?

Mr. Martin: I could not go that far.

Mr. Hamilton: If they are not making a lot of money.

Mr. Ewens: Except that, as Mr. Twaits has pointed out earlier, if for any reason we had divested ourselves of major pipeline holdings or major assets holdings, then obviously the imposition of a capital gains tax would be very severe.

Mr. Twaits: I would be very much surprised if capital gains were a significant factor in a widely held corporation of any kind of business, that is whether that would be over any period of time a significant factor in their earnings.

Senator Hays: You are saying that large companies have not benefited that much.

Mr. Twaits: There are capital gains and property transactions going on all the time, which would be very complex, due to urbanization, zoning regulations, and so on, but they would not be significant, I do not think, in any corporation.

The Chairman: Except the five-year revaluation, you have to look at that as part of the capital?

Mr. Twaits: That is right.

Senator Connolly (Ottawa West): You are not saying that you do not hold investment portfolios—you are not saying that you do not have some of your reserves invested and do not intend to realize them, and therefore they are not subject to capital gains tax?

Mr. Twaits: We are not basically a portfolio investor. In all the investments, we are closely involved with the operation. We hold a position in Interprovincial Pipeline—but we created Interprovincial Pipeline and until recently we carried the load of its debt.

Senator Connolly (Ottawa West): So your investment is re-invested?

Mr. Twaits: Yes.

The Chairman: Except, so long as the five-year revaluation provision remains, you could be badly affected?

Mr. Martin: If I understand the White Paper correctly, and perhaps Mr. Gilmour is the proper person to answer on this—if I understand it correctly, a widely held Canadian corporation, such as Imperial, is not subject to the quinquennial tax on its holding in shares in another widely held company. Perhaps Mr. Gilmour might explain that.

Mr. Gilmour: I believe that any shareholder of shares of a widely held corporation could be subject to the five-year revaluation. Senator Connolly, on one of the questions you had asked about the capital gains, within a widely held corporation, under our Income Tax Act, as it exists today—there is really no gain except a gain on the disposition of a material part of the business that is not subjected to income tax today.

You raised the question of portfolio or short-term investments. Any profit realized on the purchase and sale, say, of treasury notes and other short-term holdings, is of course income today.

One of the major problems that the United States and the United Kingdom have encountered is that they still have no satisfactory definition of what is "income" and what is "capital gain".

Many many words are written on it, but there still is not a clear good definition. If we adopt capital gains in its present form, or in a separate form, we are going to walk right into that rat's nest of legislation, trying to collect very little money but increasing our tax legislation many times in its complexity.

Senator Connolly (Ottawa West): What you do say, then, Mr. Gilmour, is that in a widely held corporation like this one, if they held a property, a service station, because there is a rezoning by-law introduced in a municipality, and if they make a profit on it, that goes right into income?

Mr. Gilmour: The greater part of it would go into income.

The Chairman: Under the present law.

Mr. Gilmour: Yes. When you look at the results of capital gains taxation, it would pass by the average to large company, because they are already paying income tax on their gains.

So far as individuals are concerned, as you know well, those who dealt in real estate in the past, say twenty years ago, have all been taxed at income rates upon profits now.

Senator Connolly (Ottawa West): The dealer.

Senator Hays: No, you still have more than one kind.

Mr. Gilmour: If you are simply an ordinary investor.

Senator Connolly (Ottawa West): Yes, that is right.

Mr. Gilmour: So far as securities are concerned, of course, the average individual has not been taxed on capital gains from securities nor, of course, has he been allowed losses. Had he been allowed losses in the past five years there would have been quite a reduction in our national income and our tax collection. So that we come down to this: capital gains will probably affect the sale of the principal residence, the sale of household furnishings—well, not necessarily household furnishings, because nobody makes a profit on those, but objects of art and things of that nature. Though frankly, how the Government is going to collect on those is hard to see.

But, really, capital gains as it is proposed will not, I think, be a major feature.

Senator Connolly (Ottawa West): I don't want to overburden the point, but as I understand the situation as it was explained this morning, it is to this effect: I require a house to live in; if I sell that house because I choose to move into a smaller place and I happen to make a gain on the sale, that is a capital gain on which I pay no tax.

Mr. Twaits: Today.

Senator Connolly (Ottawa West): While a corporation like Imperial Oil, which owns a service station in a certain place and finally has to dispose of it for reasons beyond its

control, or perhaps for reasons within its control, if it makes a profit on that, although it requires the outlet, it still has to take that gain and add it to its taxable income.

The Chairman: That is quite true.

Mr. Gilmour: Yes, it would take the gain on the physical assets.

Senator Connolly (Ottawa West): That is true.

Mr. Gilmour: Which is called recaptured depreciation. If it made a gain upon the land, then, under our present system, I would think that gain on the land would not be taxed.

The Chairman: I don't know, Mr. Gilmour. I am not sure that I agree with you on that.

Senator Hays: If he held it for 20 years and sold it, it would be a capital gain.

The Chairman: Let us start at the beginning. We are talking about a corporation. You say, "if he held". You are talking about an individual.

Senator Hays: I am talking about a corporation.

The Chairman: You will find that the law under the present Income Tax Act is that if it is a corporation that is carrying on this kind of transaction—the sale of something that it acquired, real property—the concept of the law and the stated cases is that the object of a corporation is to buy and sell, to make money, and, therefore, this is part of that operation.

Senator Hays: Those are two different things. If Imperial Oil sold a service station they had held for 20 years, that would be a capital gain and it would be treated as such.

Senator Laird: Would that not be a question of inventory?

The Chairman: The inventory? No, I don't think so.

Senator Flynn: It is not the purpose of Imperial Oil to buy and sell land.

The Chairman: I don't know.

Senator Hays: They can answer that themselves. They are here.

Mr. Twaits: I think we had better answer this service station question.

Mr. Ewens: I would agree with the statement Mr. Gilmour has made. In a situation of this kind, if after 20 years of occupation the service station property in total was resold at a profit, to the extent that the profit related to a recapture of capital cost allowance on the physical assets involved, there would be a tax payable. To the extent that there was appreciation in the value of the land, it would be a capital gain and not subject to tax.

Senator Flynn: You don't claim the appreciation on private residences. That is why the problem is not the same for a company.

But, Mr. Chairman, about the statement made by the witness to the effect that a company like theirs would not be affected by the capital gains tax, I was considering whether this tax would not be applicable to investments in a pension fund, for instance.

Mr. Twaits: A pension fund is exempt so long as 90 per cent of the securities are held in Canada.

Mr. Martin: It is proposed that the tax exempt status of the pension fund remain.

Senator Flynn: Is that retaxable on capital gains?

Mr. Martin: That is my understanding.

The Chairman: We are going to hear briefs on this point later today.

Senator Everett: Mr. Twaits, in one of your briefs you suggest that the personal tax rates should not exceed those of the United States. If it becomes necessary, and there is no guarantee from the White Paper that it would, to raise additional revenue as a result of that short fall, where would you suggest that that revenue come from? Would you suggest value added taxes?

Mr. Twaits: I lean that way after a number of years in various international forums. I really think we have to come some time, on a competitive basis, to some form of value added taxes, and I know there is a good deal of thinking along that line in the United States today. Virtually, we are the two sole countries left in this category.

However, I would not like to explore too far where I think the rest of the revenue would come from, without stating to start with that what the White Paper proposes is, of course, a vast increase in Government revenue. This has been hotly debated, I know,

and there is no inference as to why that revenue is required. What we are really talking about here is a total tax load on the economy of enormous proportions and I say, totally, you cannot afford it.

Coming back to personal income taxes, what we are very much concerned about, and as you can see we put extensive figures in the brief on comparisons of people moving around, is that we regard the White Paper comparisons as not valid. We do a lot of moving of people and we think it is a real necessity for a country that is engaging in international trade, like this country, to keep itself internationally competitive, and to do so it has to have people who have world-wide knowledge. We believe that the present differentials between personal income tax on growing management people, are already very serious as between Canada and the United States. What the White Paper proposes is a very substantial increase. Over the long run, if you are going to keep good people and train them, you cannot have very much of a differential in these taxes.

Senator Everett: Just moving on from there, Mr. Chairman, I should like to have on record table 3 from the tables at the end of the brief. At least I should like to have on record your comments about that table. It shows that an investor who invested in shares in November 1950 at a cost per share of $5.80...

Mr. Twaits: This is an illustration of the results of the quinquennial tax.

Senator Everett: That is right, and it shows that that shareholder who purchased his shares at $5.80 in November 1950 through the quinquennial tax—and I am not sure if there are sales involved there or not, although I don't think there are—would, if those shares on July 1966 were only $5.90, that is, ten cents more, be liable for a tax of $28,917. I think it would be worthwhile having on record why this is so.

Mr. Twaits: We would be delighted to have the whole table on the record.

The Chairman: The brief will be printed in the record, Mr. Twaits.

Senator Everett: I think there should be a verbal explanation of the reason behind it as well as the table itself.

Mr. Martin: The main thing here, senator, is that the quinquennial tax, or any capital gains tax that gives you losses as well as gains, says that if you make a capital gain, we just pile it on top of your salary or whatever else you have, but if you have bad luck and have a capital loss, you can wipe out your income, and then what happens? You may have a capital loss twice your salary, and the only relief you get is the tax that you pay on your normal salary which is graduated as you go up. As you will notice in the White Paper, if a person is exactly balanced on $24,000 of taxable income and if he makes a gain of $24,000, there is slightly more than $12,000 tax on it. However, if he loses $24,000 in that year, he wipes out his tax so that he saves $9,000 in that year, so that in two years, if you have a gain of $24,000 in one year and a loss of $24,000 in the next year, then over the two-year period your income would be exactly equal to your salary, but in the name of equity you pay $3,000 extra tax, and nobody has explained the equity of that to me.

Senator Everett: Going by what you say, your point is very well taken. You pay capital gains tax at the highly marginal rate and you get the deduction for capital loss at the low marginal rates.

Mr. Martin: Exactly.

Senator Everett: In the small business section, Mr. Twaits, you refer to the fact in talking about capital cost allowances not being applied purely to the property from which it is generated as not being applicable to other income. You made the point that Imperial Oil currently owns and rents out to dealerships 1,500 service stations. Can you tell me why you make that point?

Mr. Martin: The point is that in order to deal with what the White Paper describes as an abuse, and I would rather try to take a neutral position on it and I am only repeating what I believe they said with regard to abuse, a person with a good income can invest it in an apartment building and claim capital cost allowances on it and so wipe out his income or salary from his profession by claiming capital cost allowances on this apartment building, and later on when you have exhausted your capital cost allowances on the first building, you can put it on a second one. Now they propose a couple of cures to it, and the trouble is that the cures are pretty drastic, because one thing they say is that you cannot claim in computing income, any loss on any property which was created by claiming

capital cost allowances or interest or taxes. That means you have to go to a property-by-property determination of income on any rental properties you have, and I might say that the White Paper may go as far as to look at equipment rental companies because they talk about property and not about real property, and that means you have to compute your profits and losses of any rental service station or any other property you may rent out, for example a bank that rents the top floor and you have to compute its position as a landlord, property by property and it is an immense job.

Senator Everett: Let us deal with the question of service stations for a moment. Would it be sufficient if you computed the rent based on capital cost. Does that not answer the requirements of the White Paper? Your point would only come into operation if the rent for the service station were below what is required to cover capital cost allowances.

Mr. Martin: Capital cost allowances, interest and taxes.

Senator Everett: Is that a problem?

Mr. Twaits: That is a very shrewd observation because when you establish a service station it has to grow. It has to develop its business, and you do not build it and lease it to an individual on the assumption that from the day he starts operating he will be operating full blast. He may not be able to afford an appropriate rental to start with and so there is a real problem in what you suggest.

Senator Everett: But over the life of the station?

Mr. Twaits: It is not a question of the life of the station or not, but it may take several years so you do run into exactly what you have suggested.

The Chairman: Any other question?

Senator Lang: I want to ask Mr. Twaits whether it is his opinion that the publication of the White Paper has had an adverse effect on the price of Imperial Oil shares?

Mr. Twaits: Thank you very much, sir.

The Chairman: You are not answering further?

Mr. Twaits: I don't think it would be appropriate for me to answer.

Senator Carter: Just for the record, on page 59 you make the point that exploration cycles cover five to ten years, and if you make a discovery, it takes another five years. I wonder if for the record you could give us a couple of examples of this.

Mr. Twaits: We can show you several. Even in Alberta the average exploration development cycle would be between seven and ten years—for example, Judy Creek. If we have an oil field in the Arctic and assuming we have an outlet for it, the exploration cycle there will be a minimum of ten years exploration and development and probably 15 years.

Senator Carter: But do you have any examples of where it has taken five or ten years now?

Mr. Twaits: Yes, I have quoted the one in Alberta and we could quote other examples.

The Chairman: Any other questions? Mr. Twaits, do you feel there is anything more you want to add?

Mr. Twaits: No, but there are two comments I would like to make. First of all there is a matter I would like to withdraw from the record. That is a remark I made that I didn't think that capital gains would affect widely held companies. I speak of course for our own company, and I don't think I should speak for others. I don't think I know enough about it. Secondly, one thing we have not discussed but we are very conscious of and that is that one of the amazingly difficult problems that the White Paper proposes is that there is simply not enough bookkeepers and accountants to handle it, and the amount of additional work placed on a corporation which already seems to spend many millions of dollars a year in accounting to government is simply horrendous.

Finally, sir, I would like to thank you and the members of this committee for the kind treatment you have accorded to us and the excellent questions you have prodded us with. If there is anything further we can provide, we shall be most happy to do so.

The Chairman: Thank you. It may have been obvious to you that we have been going to school.

The next brief is from Elgistan Management Limited, and there are two representatives here, Mr. J. D. H. Mackenzie, President, and Mr. G. P. Keeping, the company's Auditor and Tax Adviser.

Mr. Mackenzie, are you going to make an opening statement?

Mr. J. D. H. Mackenzie, President, Elgistan Management Limited: Yes, Mr. Chairman, if I may.

Mr. Chairman, honourable senators: It is my privilege to appear before you with Mr. Keeping as representatives of Elgistan Management Limited and its associated companies, on whose behalf a written submission has already been placed before you. Mr. Keeping is a partner of Messrs. Clarkson, Gordon and Company, our company's auditors, and he did much to assist us in the preparation of our submission.

I shall keep my introduction as short as possible, since I trust our written submission provides a pretty clear account of the problems posed by the White Paper for the British and Irish investors we represent. The summary and recommendations sections of our submission provide a handy precis of our views, but perhaps I might be permitted to emphasize certain aspects.

We are particularly concerned with the proposals to treat capital gains as income, to tax non-residents on gains realized from the sale of shares in all CHCs and in WHCs in which 25 per cent or more is held by one foreign investor, and the five-year re-evaluation of shares of WHCs.

After many years of uncertainty, dating from the publication of the Carter Commission report, the future of non-resident investment companies is far from assured, and no comfort can be found in the very casual approach to NROs taken by the authors of the White Paper. It may be their view that foreign capital which has been invested in Canada through NROs is no longer needed, and perhaps the key to their thinking on this score can be found in paragraph 8.47.

When drafting this submission we were conscious that it was not our business, as spokesman for foreign investors, to try to tell the Canadian Government what it should or should not do in the way of tax reform. We did believe, however, that it was proper to draw attention to some of the more harmful proposals which the White Paper contained for investors we represent.

Furthermore, I think it can safely be said that some of the proposals which cause us serious concern must be worrying many other foreign investors. By its very nature, private capital, and particularly private foreign capital, does not seek publicity, and it is possible that not much will be heard from other foreign interests such as ours, so what we have to say may have implications beyond merely stating our case. To vary an expression in common use, we might call this the foreign investment iceberg.

Thank you.

The Chairman: I am wondering, Mr. Mackenzie, how this company operates.

Mr. Mackenzie: I think I could refer you and the committee to the chart, Appendix A of our brief.

Basically, we represent non-resident private individuals and trusts, who are resident, as we have said, largely in the United Kingdom and in the Republic of Ireland. These individuals have conducted their investment in Canada through the medium of non-resident owned investment companies. It is a special type of investment corporation which grants special treatment to companies which qualify.

These non-resident owned investment companies, in turn, have invested in a privately formed open end unit trust. The idea behind this is that we have collected this pool of capital and we are managing it in the form of a unit trust. Under present laws that is not taxed at all because its income flows straight through it and is taxed in the hands of the NRO, because we make full distribution of all income from the unit trust.

Senator Connolly (Ottawa West): The NRO is taxed at home?

Mr. Mackenzie: No, the NRO, the non-resident owned investment corporation, is a Canadian federal corporation. It is taxed under the tax laws here at 15 per cent of its income.

Senator Connolly (Ottawa West): It pays to its shareholders abroad?

Mr. Mackenzie: Yes, that is right.

Senator Connolly (Ottawa West): I am just clarifying it.

Mr. Mackenzie: That is correct. The income, when received by the NRO, suffers tax at 15 per cent.

Senator Connolly (Ottawa West): Yes, that is the only Canadian tax?

Mr. Mackenzie: Yes, the dividend from the NRO corporation to the shareholder abroad passes out tax free; there is no further Canadian tax.

The Chairman: This is the present law, and there has been a similar law for some time, under section 70 of the Income Tax Act, so they pay a 15 per cent tax. We have had an interesting case of this kind already, Mr. Mackenzie, foreign investors who brought units in a Canadian common law trust, as they call it, and they had a property management company because this was a real estate operation. They did not come under the provisions of the NRO companies, but your operations are such that you operate through NRO companies?

Mr. Mackenzie: There is a definition in the act, or a qualification; but, first of all, I think 95 per cent of the shares must be beneficially owned by foreigners or non-residents of Canada. The sources of the company's income are restricted so that it can only earn, I believe it is, 10 per cent in the form of rents and royalties. The rest must be what one might call a true investment income.

The Chairman: Yes, not more than 10 per cent of its gross revenue is derived from rents, hire of chattels, charterparty fees or charterparty remunerations. That is the limitation that you have to live up to.

Mr. Mackenzie: That is right. I am talking about portfolio investments here. I should go on to say also that in this group we manage are other private companies, and it is possible for NROs to own shares in other private companies which, under the White Paper proposals, would be CHCs. These CHCs engage in all sorts of activities, but real estate would be one of the major areas of involvement in which we are interested.

The Chairman: This kind of set-up would be that you would have an NRO company in which 95 per cent of the shares would be held by non-residents?

Mr. Mackenzie: That is correct.

The Chairman: One method of operation might be that that NRO company would have a subsidiary company.

Mr. Mackenzie: Yes.

The Chairman: And at least 95 per cent of the shares of that subsidiary company would be owned by the No. 1 company.

Mr. Mackenzie: That is not necessarily so.

The Chairman: It could be.

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Mr. Mackenzie: Yes, it could be. You could have that situation, but it is possible for an NRO to have underneath it what we might call an ordinary tax-paying company.

Senator Connolly (Ottawa West): A which?

Mr. Mackenzie: An ordinary tax-paying company; in other words, just a company taxed...

Senator Connolly (Ottawa West): At 15 per cent?

Mr. Mackenzie: Yes, and the NRO still would not be disqualified because it would receive income in the form of dividends. It would still be investment.

The Chairman: Do you encompass those various situations? Are there some subsidiaries which are 95 per cent owned by the number one company?

Mr. Mackenzie: Yes.

The Chairman: And then there are other Canadian companies which are subject to the regular corporate rate of taxation in which this number one company owns some shares, but the quantity may differ in different cases?

Mr. Mackenzie: Yes. I think that perhaps I should say there are quite a number of NROs. You migt say that there might be ten NROs, and they would all have shares in one ordinary tax paying corporation.

Mr. G. P. Keeping, Auditor and Tax Adviser, Elgistan Management Limited: Perhaps to simplify the object of the NRO company, as I understand it, it permits income, which if it were held directly by a non-resident would only be subject to the withholding tax, to be taxed only in Canada at the withholding tax rate. But other income which would be taxable if received by a non-resident, such as one carrying on business or having a permanent establishment in Canada, would be subject to tax at normal rates.

The Chairman: Indirectly, then, once you establish your number one NRO company, a group could have shares in varying quantities in a Canadian company whose chief occupation or objective may be dealing in real estate, and this would not destroy the status of the number one company because it would only be in receipt of dividends?

Mr. Keeping: That is right, but the company that was dealing in real estate...

The Chairman: Yes, it would be subject.

Mr. Keeping: In point of fact, in this particular organization—and I do not think Mr. Mackenzie will mind my mentioning it—they are not engaged in dealing in real estate.

Senator Connolly (Ottawa West): Can we dwell on one point for a moment, Mr. Chairman. I take it that the purpose of the 15 per cent tax in respect of non-resident owned companies was to attract capital to Canada, and to allow the dividends that they earn to be paid at a preferred rate. Can Mr. Mackenzie give us any idea of the extent of the success of that provision of the act?

Mr. Mackenzie: That is an extremely interesting question, sir, but I am not sure where we would find this information.

Senator Connolly (Ottawa West): Could you take your own company as an example? I do not want you to disclose matters that you do not want to disclose, but is the volume of capital that you attract to Canada because of this 15 per cent rate of tax that you pay substantial?

Mr. Mackenzie: May I answer that a little differently from giving you a straight answer? I think we might say that we were very interested in Canada anyway. This was a decision made long before I came on the scene. However, I would say that the hospitable tax climate had much to do with it. The NRO is an extremely helpful company through which to invest.

Senator Connolly (Ottawa West): It is a magnet?

Mr. Mackenzie: Yes, but to what extent this has drawn in other people I could not say. However, I do think that we could have arranged our affairs in a completely different way.

Senator Connolly (Ottawa West): You could have gone to another country?

Mr. Mackenzie: Exactly, but it seemed right and proper that we should have companies here.

Senator Connolly (Ottawa West): And you felt you had a stable political organization, and that kind of thing.

Mr. Mackenzie: Yes.

The Chairman: I think Mr. Gilmour has something to add in answer to your question.

Mr. Gilmour: I can state, Senator Connolly, that by a freak of circumstance I became a tax collector in 1937. The NRO legislation was introduced in 1936. In 1936 there was a division between such a company and what is now called the foreign business corporation. Brazilian Traction used to be one of the outstanding examples. The foreign business corporation provisions over the years became restricted to public manufacturing, mining, and utility companies. The NRO provisions became restricted to what you might call per folio investment in Canada.

The object of the NRO provision, as it developed from 1936 on, was to enable a non-resident to hold investments in Canada, and pay no more Canadian tax than he would pay had he held those same investments directly in the United Kingdom, or whatever country in which he happened to live.

Over the years the NRO provision has gradually been restricted in its concept, and today the income that a NRO corporation can receive is strictly restricted to investment income, dividends, and interest, and one or two other investment income items.

Away back in 1936 it must be admitted that these NRO provisions were used for the evasion of foreign taxes. As a youngster I can remember that various outstanding movie actors in the United States would create an NRO company, would hire themselves out at slave wages to the company, and arrange that it received the fee paid by the producing studio. In those days our rate of withholding tax was 5 per cent. Consequently, these actors were able to pay the 5 per cent on the revenues that they received from their acting, and then having paid the 5 per cent they could draw out their earnings as a redemption of a note, so that they would pay no tax in the United States other than the 5 per cent. There were some lovely schemes that I can remember tracking down as an enthusiastic tax collector, but those have all long since disappeared.

The Americans closed that loophole in about 1939, and the British closed it prior to the outbreak of World War II, so that today your NRO corporation is strictly a holding company for non-residents. Under our present law the NRO corporation pays Canadian tax at 15 per cent only. It can then distribute the remaining 85 per cent free of any other Canadian tax.

Now, the White Paper...

Senator Connolly (Ottawa West): Do you mind if I interrupt you, Mr. Gilmour?

Mr. Gilmour: No.

Senator Connolly (Ottawa West): The shareholder of a company which is a non-resident owned corporation—the man abroad—will pay taxes on the dividends he receives at the tax level in his country of residence? Is that so?

Mr. Gilmour: Yes, Senator, and that would vary with the country of residence. Ordinarily, in the present context, we are speaking of residents of the United Kingdom and the Irish Republic. Even with all the very enlightened tax incentive laws that the Republic of Ireland has adopted, they still levy pretty heavy personal taxes on their residents. Therefore, in the present incidence we can say that dividends received in either of these countries will be taxed at very heavy rates. There will be relief for the 15 per cent Canadian tax and, of course, if underneath the NRO there are Canadian manufacturing companies, there could be relief for some of the tax paid by them as it flows through.

Senator Everett: Is there any requirement to pay out the income on the NRO?

The Chairman: No, because the tax is on the income; the Canadian company pays it.

Mr. Gilmour: It is prepaid. You can leave it or pay it back to the non-resident whenever you feel like it.

Senator Everett: Which is the advantage of a non-resident holding to the NRO rather than personally.

The Chairman: There is one obvious advantage, that if they do not want to take it home they can accumulate it here?

Mr. Gilmour: That will work with some countries to some extent, but there are others who simply would look through it.

The Chairman: That is right.

Mr. Gilmour: The basic advantage of the NRO has always been administrative. You are holding things together. In the event of a death, of course, there would be no Canadian succession duties or estate taxes, because a corporation does not die. There are many other practical advantages to these companies. The White Paper, mistakenly in my view, seems to infer that there is something improper about an NRO, that it is primarily a tax evasion dodge. I would merely submit here as your adviser that the NRO has long since had a clean bill of health and it is today a very practical device for a non-resident who wants to invest in Canada. The White Paper proposals, as you are aware, do intimate that our general withholding rate should move from 15 per cent as at present to 25 per cent if other countries will agree to an amendment to our conventions. Secondly, it obviously infers that gains realized by an NRO, while capital gains, would fall into the income of the NRO, whereas a similar gain realized directly by a non-resident holder would ordinarily not be subject to Canadian tax. There are one or two exceptions to that, but the White Paper as it stands today is in effect going to drive the NRO out of Canada.

The Chairman: To drive it out mainly on account of the second point that you mentioned, the exposure to capital gains.

Mr. Gilmour: Yes.

The Chairman: Because the other change in impost is stepping up the tax rate from 15 per cent to 25 per cent.

Mr. Keeping: I think it is fair to say that it is not really possible from the White Paper to say with any certainty how it is proposed to tax them, even on income, other than the suggestion that the rate should be raised and should be equal to the withholding tax rate. It does not say whether it should be the withholding tax rate applicable to the country where the shareholders live where there is a tax agreement with that country, for example, that would reduce the rate from 25 per cent to 15 per cent.

The Chairman: No, that is quite true. The provision in the present law, section 70, subsection (2) reads:

> The tax payable under this Part by a corporation for a taxation year when it was a non-resident-owned investment corporation is an amount equal to 15 per cent of its taxable income for the year.

If they mean what they say in the White Paper in paragraph 6.40 on page 77 you would simply substitute 25 for 15. Therefore that is the only corporate tax that the NRO would be subject to, but that does not exclude the possibility of being subject to capital gains.

Mr. Gilmour: And it does not exclude the problem if integration of dividend gains is

adopted. The NRO I suppose theoretically is a resident of Canada because the directors meet here.

The Chairman: It is incorporated here.

Mr. Gilmour: Yes, although in this case NRO's were old incorporations, but they will be faced with the five year re-evaluation if it is adopted. They will be faced with the integration of dividends, but by no means is it clear whether credit will be given against the 15 per cent tax. Therefore generally some of the White Paper proposals are reasonably clear, but others are very hazy. Of course, my purpose was merely to say that the NRO is not a tax dodging device, but is a perfectly proper management arrangement for non-residents.

Senator Connolly (Ottawa West): Would you go farther, and say that over the years since 1936 the existence of the provision with respect to NRO's in the Income Tax Act has in fact attracted foreign capital to Canada?

Mr. Gilmour: To my knowledge as a former tax collector, Senator Connolly, the answer is very definitely yes, because the NRO today enables you to use the corporate form of investment without attracting any extra Canadian tax.

The Chairman: And to avoid the estate tax problem.

Mr. Gilmour: Yes. When we had a tax convention with the United Kingdom prior to 1964 our withholding tax rate was reduced to zero when the dividends were paid by a Canadian company that was the wholly-owned subsidiary of a British company. We renounced that agreement in 1964. Up to that date where the holder was a resident of the United Kingdom there were other devices in Canada that could be used more attractively. However, it is obvious from the brief before us that these particular investors have used the NRO procedure consistently for many years prior to 1964, probably right back to the 1936 introduction of the NRO status. But there was a great influx of capital as a result of these holding companies.

Senator Connolly (Ottawa West): I suppose the logical development would be that as pools of capital are developed in time in Canada, governments would look at this 15 per cent withholding tax and say, "Well, you don't need that incentive so much, so we can increase it and get more revenue ourselves." Perhaps the White Paper is a step in that direction. In the meantime, certainly at the present time, Canada is not in that happy position of having adequate pools of capital for development.

Mr. Gilmour: No, far from it. I do not think there is any quarrel with the theoretical proposal to increase the withholding tax, because if the tax moved from 15 to 25 per cent the non-resident holding an investment in his own name would still be subject to that 25 per cent rate. Consequently, the proposal to increase the withholding tax really does not hit at the NRO. What does hit at the NRO is the proposal to tax it on capital gains, whereas the non-resident holding directly is not ordinarily taxed on the capital gains.

The Chairman: He is not taxed, the non-resident, unless it is in excess of a 25 per cent holding.

Mr. Gilmour: Yes.

The Chairman: So that non-residents having controlled blocks would be subject to capital gains tax.

Mr. Gilmour: Yes.

Senator Everett: That is of widely-held corporations?

Mr. Gilmour: Yes.

Senator Everett: What happens in closely-held corporations?

Mr. Gilmour: The proposal is that non-residents would be taxed.

Senator Everett: Regardless of the percentage they hold?

Mr. Gilmour: On closely-held there is a lot of gibberish in which the Canadian vendor would be required to produce a certificate that the tax was paid in the event of a sale of closely-held shares.

The Chairman: The closely-held would not be subject to the five-year revaluation.

Mr. Gilmour: No.

The Chairman: But the widely-held company would.

Senator Everett: In appendix B they talk about the position of the NROIC which receives its income from an open-end unit trust, which I gather is about the same thing as receiving it from a widely-held corporation.

Mr. Mackenzie: Yes.

Senator Everett: Is the NRO in the same position as the non-resident investor who is acting directly in this particular example?

Mr. Gilmour: This particular example deals more with the open-end trust, not so much the NRO. As I gather from the organization chart, exhibit A, there is a combination of NROs held by trusts on behalf of the non-resident shareholders. The proposal in the White Paper is that trusts be subjected to a 50 per cent corporation tax if they have a certain number of unit holders or beneficiaries. Here you have a peculiar combination that if NRO shares are held by a Canadian trust, under the White Paper there would be a 50 per cent tax imposed on the income of the trust.

Senator Everett: Even though those investments were portfolio investments?

Mr. Gilmour: Yes. Under our present law, of course, a trust that owns shares of an NRO pays no additional 15 per cent tax. It is a conduit whereby the income of the NRO flows right out of Canada.

The Chairman: Or as a condition of that it must cause its income to flow out.

Mr. Gilmour: Yes, as a trust. So there is no duplication of tax. Under the White Paper proposals there is first capital gains levied on the NRO itself, then a proposal that there be a 50 per cent tax. In other words, the trust would cease to be treated as a conduit and instead will become akin to an ordinary Canadian corporation paying a 50 per cent tax rate.

Senator Everett: Is there any tax credit to the trust from the tax paid on the dividend income?

Mr. Gilmour: It is not clear in the White Paper. My assumption is that there will be no credit given, or at the outside there would be a credit of 15 per cent. However, that is certainly not clear from the White Paper. Looking at it realistically, it seems as though this would be a superimposed 50 per cent tax. The combination of these two things would certainly drive these companies out of Canada. Whether it will drive the investment in Canadian securities out of Canada is not for me to say. The purpose of this brief will be explained by the gentlemen submitting it, but I did want to say that the NRO and the related trust, which is a long established thing in Canadian tax law and has been a successful arrangement, is receiving extremely severe treatment. It is against the background that there is something improper about these organizations, and I simply wanted to make that background in listening to these gentlemen's suggestions.

The Chairman: Let's do this acrobatic stunt. Let us assume the individuals, non-residents, have been implanted in place of the NRO company and they all have percentages of the investment. Under the proposed legislation what would their position be? Let us assume there were ten of them.

Mr. Gilmour: In such a case, ten individuals, probably members of a family or families, they hold it directly, so their manufacturing companies would continue to pay the 52 or 50 per cent tax rate. Then there would be a withholding tax of either 15 or perhaps 25 per cent going directly to the ten non-residents.

The Chairman: If you stop right there, the only difference so far between that and what is would be the 25 per cent as against the 15 per cent.

Mr. Gilmour: Yes. That would affect the NRO too.

Senator Connolly (Ottawa West): What is the liabilty for estate tax or succession duty?

Mr. Mackenzie: That is not affected. Could I cover that point?

Mr. Gilmour: Surely.

Mr. Mackenzie: I think the question of estate tax is if you had an individual who owned a block of shares of Imperial Oil.

Senator Connolly (Ottawa West): I thought that was what you were talking about.

The Chairman: I wanted to say that if the NRO company and the non-resident is forced out of that position and you put the individuals there—it has not gotten to the stage of what is the change of position.

Senator Connolly (Ottawa West): You are still talking about the NRO set-up?

The Chairman: Yes.

Mr. MacKenzie: I think it has earlier said that the NRO might be a way of overcoming the estate taxes. I do not think that this is so, because the estate taxes will fall on the person in his country of residence. If he dies

his NRO changes hands. It is immaterial to him whether he holds his shares through NRO.

The Chairman: You misunderstood me, Mr. Mackenzie. The estate is actually in Canada. If a non-resident holds Canadian securities in the corporation and then that corporation continues to exist there is no estate tax attracted by that in Canada. Of course, he has got whatever the estate tax problems are where he resides.

Mr. Mackenzie: Could I ask this question? If the case in point is 10,000 shares of Imperial Oil of which he holds directly and he dies while living in England there is no Canadian estate taxes levied on that?

Mr. Gilmour: It would be a 15 per cent Canadian estate tax levied on that value. That was the state tax to which I was referring, whereas if that was held through the NRO and a trust, conceivably there would be no 15 per cent Canadian state tax. Following your illustration, Mr. Chairman, when we turn to capital gains tax presumably the 10 individuals would own the various subsidiary companies—if I can use that phrase—in ten ways so that perhaps some of them would have more than 25 per cent.

The Chairman: That is right.

Mr. Gilmour: Therefore, these non-residents would escape all Canadian capital gains taxes if they broke the thing up. Now, it is not always convenient to break up these large, well established NRO's and the trusts because of the volumes of existing estates in the United Kingdom and all of the other arrangements. The way our White Paper proposals work is that these people would have no option but to break up long established arrangements. In the process of breaking these up there would arise the question, do the various 10 individuals re-invest in Canada or do they go elsewhere?

Senator Connolly (Ottawa West): There might be a flight of capital.

Mr. Gilmour: There could very easily be, Senator.

The Chairman: It would appear to be a definite risk that there would be. The only question is how quickly they could move it.

Senator Connolly (Ottawa West): The incentive provided by the NRO disappears.

The Chairman: Do we agree with that?

Mr. Mackenzie: Yes.

Mr. Keeping: The burden of our brief, so far as our particular organization is concerned, that is apart from other recommendations, is that under tax reform the non-resident who operates through a non-resident owned investment corporation should bear no more tax than if he owned the securities directly in his own name. As you know, under the White Paper proposals it is proposed to tax non-residents who hold directly real estate branch assets and partnership interests. In effect, under the present definition of a NRO you cannot hold those assets. This is really the burden of our argument that from the point of view of the investors the NRO, having an establishment in Canada, has very distinct advantages rather than being the non-resident owner. It has certain advantages when you are managing a pool of assets to have qualified personnel managing them.

Senator Connolly (Ottawa West): Managing them on the spot.

Mr. Keeping: Yes, on the spot. Our plea, so far as portfolio investments are concerned is that a non-resident who composes through the medium of a non-resident or investment corporation be not subject to say higher taxes than he would be if he held those portfolio investments directly.

The Chairman: In other words, you look through the vehicle and treat them as non-resident individuals?

Mr. Keeping: That is exactly what our present law does.

Senator Isnor: Where are you located, Mr. Mackenzie?

Mr. Mackenzie: In Montreal, sir.

The Chairman: This is your point?

Mr. Keeping: That is the major point as far as our specific situation is concerned. We also do not feel that the capital gains tax is a good thing for Canada in Canada's present stage of development.

The Chairman: Your viewpoint is interesting. Why don't you feel there should be a capital gains tax?

Mr. Mackenzie: Do you want me to answer that?

Mr. Keeping: Yes.

Mr. Mackenzie: I would take my cue from what Mr. Twaits said in the submission made by Imperial Oil that the stage of development in Canada is such that the formation of capital should be encouraged and not discouraged. I do not see what the White Paper does to encourage the formation of capital. The White Paper does precious little to excite the people who bought Canadian shares before it was introduced or to buy them after it was introduced. They will have a capital gains tax, whereas now they have none. If we get down to the realm of accuracy it is desirable to catch those people making trading profits and living off their capital gains. I think the machinery exists in order to catch those people. It is a question that these rules should be applied a little more vigourously. Frankly, I do not subscribe to the idea because there is doubt as to whether a particular transaction results in a capital gain or it is income and whether there is any reason to go into the complication of a full scale capital gains tax. In Britain it causes many problems.

The Chairman: Would you say that they have seen the error of their ways?

Mr. Mackenzie: I think they are trying to simplify it now.

Senator Connolly (Ottawa West): Is it realistic though, Mr. Chairman, that the climate of today in public opinion in Canada, assuming Mr. Mackenzie is 100 per cent right, to think that in some form or another we are going to have a capital gains tax in this country? Let me ask a further question. Since the proposal is to put a capital gain in with income and tax it 50 per cent, you think that, if we are going to have one, we should have a Capital Gains Tax Act rather than lump it in with the income?

Mr. Mackenzie: I feel very definitely that it should not be integrated with income. I feel that capital gain is completely different from earned income. It is made through a person's savings, it fluctuates, you cannot say that it is income. I know that economists say it is income, because it increases a man's economic power. But I do not hold with that, and I think that if there is to be a capital gains tax then it should be a specific capital gains tax quite separate from the taxation of income.

The Chairman: Because it is a distortion, really, of a concept of income, to call a capital gain as we understand it, "income". In the present Income Tax Act, they distinguish, they say it is income if the gain results from an adventure in the nature of trade, but that is in the definition of income. But then what is left, which is a true capital gain, is not income, it is a gain. And clearly—this is not an argument against taxing a capital gain, but it is an argument in favour of saying that it should be a specific tax.

Senator Connolly (Ottawa West): There is a gain, too, in an investment that makes it different from income, because you can have capital losses.

The Chairman: Yes. Do you want some witnesses?

Senator Connolly (Ottawa West): I will give you one.

Mr. Mackenzie: I see you are anxious to conclude.

The Chairman: No, no. Please proceed.

Mr. Mackenzie: There is one further thing I should like to add, that concerns us tremendously, that is, the proposal to tax gains made on the shares of closely held corporations by foreigners. We do not think this is a good thing. There is an example in Germany, where this happens, where there are substantial interests involved. We think that this is going to make investment on Canada very unattractive. When a foreigner comes and invests in Canada in a closely held corporation, if he is going to be stuck with a 50 per cent capital gain at the end of the road, I cannot for the life of me see what interest he would have in making such an investment. It may be that this sort of capital should not be any longer needed, or perhaps it is no longer desirable, in the view of the authors of the White Paper, then it should be pulled into Canada. But I leave that question in your minds.

The Chaiman: When you say 50 per cent, the concept in the White Paper is that ultimately the individual highest rate would be 50 per cent. But there is no guarantee that even if they get the 50 per cent, that it will stay there.

Mr. Mackenzie: But the foreign shareholders would not have any of the creditable side which is available to the Canadians. In other words, it would be a flat loss to him, as I see it, at this stage.

The Chairman: There are these two aspects, then.

Senator Connolly (Ottawa West): When you talk about flat loss, you mean the difference between 15 and 50?

Mr. Mackenzie: No, I am talking about capital gain. If a Canadian resident invests in CHC and makes a gain, that is taxed at 50 per cent, and he is allowed the losses on the other side. But the foreigner loses that completely. There is no offsetting provision. Perhaps I am really making a case against the 50 per cent rate on CHC, the full rate of capital gains tax.

Senator Connolly (Ottawa West): I would like to pursue this.

The Chairman: I am not satisfied, either. Mr. Gilmour might clarify this.

Mr. Gilmour: At the moment, the proposal is that non-residents would be taxed upon the profit from the sale of shares of closely held corporations. I would assume the proposal would require the non-residents to pay the personal Canadian tax rates upon this gain, which personal rates at the moment could be anywhere from 84 per cent down to the theoretical 50 per cent that is suggested five years hence.

As far as the Canadian shareholder is concerned, he too would be subject to tax on the gains of shares in closely held corporations. He would have to include the full gain in his income, or deduct the full loss from his income.

The Canadian is in the position that he presumably as other earned income in Canada and if he has a loss, then at least he has got something to re-apply the loss against. The non-resident shareholder presumably would only be taxed on the gain from the sale of shares, or he would have a loss deduction allowed him if he had a loss, but if he has no other income in Canada, that is mighty poor consolation to him.

I cannot avoid realizing that I always look for the loopholes in a law rather than what it says. I would simply say, if this White Paper comes about, that any non-resident would be a silly ass to invest in the shares of a closely held corporation. What the fellow ought to do is make sure that it suddently becomes a widely held corporation...

The Chairman: That is right.

Mr. Gilmour: ... and then invest quite happily in it. This is undoubtedly what will happen.

Senator Everett: Unless he owned more than 25 per cent?

Mr. Gilmour: Yes.

Senator Everett: What is the rationale for that, in your mind?

Mr. Gilmour: I have no rationale...

The Chairman: They offer something in the White Paper, but I do not think it would qualify really as a rationale.

Mr. Gilmour: What is going to happen in practice is, when you have a group of non-residents, it is the most simple thing in the world to make sure you do not have 25 per cent. So all this does is not going to produce more dollars for Canada but produce some lovely reorganizations whereby accountants will profit...

The Chairman: And the lawyers.

Mr. Gilmour: Yes, and the lawyers, and perhaps they will profit more. That is all that will happen. There will be great upset and possibly the loss of investments to Canada, which is always the serious aspect.

Senator Lang: How would the tax be enforced against a non-resident who would hold in a closely held Canadian corporation?

The Chairman: The shares, the subject would be here.

Senator Lang: How would it be enforced against the non-resident?

Mr. Gilmour: There is a lot of gibberish about requiring a certificate of compliance from a Canadian vendor, but how you would get the certificate from another non-resident vendor is beyond me. I suppose in theory if it were a widely held company, if you have a 25 per cent interest, you probably have more, and there would be a record here in Canada of that. But for individual non-resident shareholders it is going to be the most simple thing in the word to arrange their affairs so that they do not pay another penny of tax.

The Chairman: Just don't have 25 per cent.

Mr. Gilmour: Of course. Sometimes that is not easy where you have estates in the United Kingdom and many other things that prevent

you from making these changes, but sooner or later they will be made.

Senator Molson: In the meantime, there is in essence a strong deterrent for investment at all. The mere fact that it is possible to arrange your affairs implies that you have to go to considerably more trouble, and in the end you will probably say, "let's stick it in the Isle of Man or in Guatemala".

The Chairman: The investment climate will not be at such a high temperature.

Senator Burchill: Mr. Mackenzie, how old is your company?

Mr. Mackenzie: I think the interests we are talking about have been in Canada for 40 years, but the entities have changed.

Mr. Keeping: Individuals have died during that period.

The Chairman: Mr. Mackenzie, is there anything else that you want to add? Or you, Mr. Keeping? Is there anything you want to add on this subject now?

Mr. Keeping: I would emphasize that we felt it was equitable that our interests be treated as though they owned these investments directly as non-residents, and we have made what we feel to be constructive suggestions in order to achieve that objective.

Senator Carter: You say on page 4 that your company has assumed risks in ventures which Canadian investors have not been prepared to take in the past because the risk was too great and so forth, and they did not have the capital. In another part of your brief you say that you provided not only capital but management services as well. My question is, do any of your companies operate as what we would call developmental companies?

Mr. Mackenzie: A development company?

Senator Carter: Yes. I think Senator Lang will bear me out that from the evidence before the Science Policy Committee it became obvious that there was a need in Canada for development companies. Many enterprises are lost to Canada because persons who have inventions cannot get capital. Although they can carry their inventions through to the point where they can develop a prototype, they cannot get in Canada the capital or the management services needed to put the invention on an enterprise scale and bring it to fruition on the market. Investors have to go to other countries for the money and management services and those other countries reap the benefits. Do your companies provide that kind of capital?

Mr. Mackenzie: We don't. I think you are referring to what might be called venture capital and the supply of venture capital to new inventions and new technology.

Senator Carter: Yes.

Mr. Mackenzie: I must admit that we have not played a leading role in that. Our investments have been in the more conventional type.

The Chairman: Portfolio.

Mr. Mackenzie: We have direct operating companies, but I cannot say to you that we have sort of carried a brilliant idea for an inventor or financed a brilliant idea for an inventor through to the commercial stage. We have not done that.

Senator Carter: My point was that the evidence pointed out a need for this kind of company in Canada and I gathered from your presentation that the White Paper proposals would discourage that.

The Chairman: That has not been their method of operating, and, of course, it is up to the man who has the money to decide how he is going to use it.

Senator Connolly (Ottawa West): We need both kinds of capital in Canada.

The Chairman: Yes.

Mr. Mackenzie: I might say that venture capital is a very specialized role.

The Chairman: Thank you very much, Mr. Mackenzie and Mr. Keeping. I understand the points you have made and I have read your brief. If you think we have missed something please tell us. This is your chance.

Mr. Mackenzie: I hope we have not.

The Chairman: All right. We will adjourn now until two o'clock this afternoon.

The committee adjourned to 2 p.m.

Upon resuming at 2 p.m.

The Chairman: I call the meeting to order. We have several briefs still to deal with this afternoon. The first one is from William M. Mercer Limited dealing with employee benefit

plans. Representing this company are Mr. K. O. Macgowan, President, Mr. L. E. Coward, Executive Vice-President, Central Region. I understand Mr. Woods is not here?

Mr. K. O. Macgowan, President, William M. Mercer Limited: No, Mr. Chairman. He did not make it.

The Chairman: Now, would you care to open up and if you have a summary, we would be interested in getting the discussion under way.

Mr. Macgowan: Honourable senators, I must apologize for Mr. Woods' absence which was unavoidable.

We have presented to you a very short brief on the subject of employee benefits which were touched upon in the White Paper. This brief has been prepared by our representatives across Canada, and it is a pretty good consensus of their feelings. I think it would have the support of the majority of our clients, but naturally our clients have not seen this as yet.

I would like to have Lawrence Coward who is with me and who is, by the way, a Fellow of the Institute of Actuaries of Britain, a Fellow of the Canadian Institute of Actuaries and an associate of the Society of Actuaries of the United States. He has done the major share of the work in preparing this report, and I would like to ask him, with your permission Mr. Chairman, to summarize very briefly the main points.

Mr. L. E. Coward, Executive Vice-President, Central Region, William M. Mercer Limited: Thank you, Mr. Chairman. I think it may be helpful if I outline the seven major recommendations. The first point is that it is proposed in the White Paper that pension plans be subject to a limit on the amount of benefit rather than a limit on the amount of contributions being put into the plans. We support the recommendation, but we have reached the conclusion that you really must have both a contribution limit and a pension benefit limit. In practice, this is what happens at the present time because there is a limit on input in the Income Tax Act, and the guidelines of the Department of National Revenue put a limit on the amount of the pensions. We believe that the limit must be related in some way to length of service so that there could not be a payment in of several hundreds of thousands of dollars for one individual in one year and we believe that the limit should be related to earnings.

The second conclusion is that basically there is not very much wrong with the present system, except that it is unformalized and far too much depends on ministerial discretion. There have been a number of rulings and guidelines which did not take the form of amendments to the act, and did not take the form of regulations but were just sudden statements that came out, in some cases with retroactive effect, and we feel that the rules respecting pension plans should be formalized and written into law.

The Chairman: Well, if you would stop right there, Mr. Coward, you are now addressing yourself to the question of employee benefit plans?

Mr. Coward: Yes.

The Chairman: You have stated the provisions of the Income Tax Act in relation to them now. What does the White Paper propose?

Mr. Coward: The White Paper proposes, as I understand it, that the provisions for pension plans should be specified in the Act so that we are in fact in accord with the White Paper.

The Chairman: That is to say you are going to put in legislation what is operated by discretion or rule?

Mr. Coward: Yes.

The Chairman: And are you proposing they put in the Act what is presently the extent of the discretion and direction in which it goes, etc?

Mr. Coward: I would not go quite that far. There are certain rules respecting shareholders and so forth that I think are very discriminatory, and were taken as emergency action and should not be reproduced in their present form.

The Chairman: Well, will you tell us about that? I want at some stage to get in summary form what it is that you think should be done with the White Paper in relation to employee benefit plans, etc. based on your experience.

Mr. Coward: We think that a registered pension plan should be defined in the Income Tax Act in the same way that a registered retirement savings plan or a profit-sharing plan is defined. At the moment, a registered pension plan is whatever the Minister in his discretion sees fit to register.

The Chairman: Well, if you went back on that, is it not largely the parties who are concerned with this? If the company and the employees prepare a plan and file it, almost invariably it is registered, is that a correct statement?

Mr. Coward: That used to be the case, but it is not exactly the case at the moment. First of all, provincial registration under the Pension Benefits Acts of the province where they exist is a precondition normally of registration by the Government of Canada. Secondly, there has been an attempt to prevent abuses which are considered to occur if shareholders participate to too a great an extent in the plans.

Senator Connolly (Ottawa West): Well, you do have certain restrictions, do you not, in that the maximum contributions under the Tax Act are $2,500 if you are not otherwise in a plan and $1,500 if you are?

Mr. Coward: Yes, but the contributions of the employer while limited to $1,500 in the first instance can be supplemented by payments in respect of deficits or past service liabilities, and these are without limit, and it is so easy for an employer to pay much more than $1,500 in respect of an individual.

Senator Connolly (Ottawa West): Am I wrong in this? He can pay $1,500 for current service and $1,500 each year for past service?

Mr. Macgowan: That is an employee.

Mr. Coward: The employer can pay $1,500 a year for current service and an amount which is virtually unlimited for past service or for deficits. And if you promise benefits that are worth much more than the contributions will provide, the employer can put in large sums for an individual.

Senator Isnor: Is it not a fact that all such pension plans must be approved by the Government?

Mr. Coward: Yes, it is. And in that approval the Government has been using guidelines which they have prepared as to what they consider reasonable in a pension plan. These guidelines have changed rather frequently.

Senator Connolly (Ottawa West): For past service?

Mr. Coward: And for other items. They will not approve of plans which are primarily for the benefit of shareholders; for example, a plan which provides too large pensions for widows would not be approved. There is quite a series of guidelines being used because there is so little in the way of law.

Senator Connolly (Ottawa West): In the White Paper you say they are actually silent on this?

Mr. Coward: No, the White Paper proposes that the Income Tax Act would provide what a pension plan is and the investment powers and a number of other matters of that sort.

Senator Carter: Would the capital gains provision in the White Paper affect the pension funds invested.

Mr. Macgowan: No, sir, I do not think so.

The Chairman: What I would like to get at, Mr. Macgowan is, I have read the few words in your brief. I see that what you recommend is that employee benefit plans should continue to be encouraged, because of their social and economic value, by favourable tax treatment." Supposing you address yourself to that, what does the White Paper propose which you think does not go far enough in encouragement?

Mr. Macgowan: I would say that one of the major areas is in widows' benefits where the proposal, as it stands now, is to provide widows' benefits only up to the accrued pension the man has received at the date of death, or is entitled to at the date of death, so that a man dying at age 30 really has not had any chance to build up a widow's pension, and he is really the one who needs the widow's pension.

Our recommendation would be that widows' benefits be substantially increased, possibly providing half the pension the man would have been entitled to at retirement, had he continued through from 30 to 65.

The Chairman: But it becomes a matter of dollars and cents. It would involve payment out of the funds of larger amounts of money.

Mr. Macgowan: There is no question about this, that this would cost more money.

The Chairman: Yes. What would you lean on to provide the additional funds? Do you envisage taking it away from somebody else?

Mr. Macgowan: No, the employing company would have to pay in more money. The corporations would like to do this through their pension plans.

The Chairman: As long as it were permissible.

Mr. Macgowan: As long as it were permissible.

Mr. Coward: And under the present guidelines it is not permissible.

The Chairman: There would have to be some kind of limit. That is, if you take the example you cited of a man of 30 years of age dying, leaving a widow, the pension, if any, to her would be negligible. He would not have paid much in the way of contributions during that time.

Mr. Macgowan: That is correct.

Mr. Coward: That is the difficulty.

The Chairman: How do you evaluate the kind of pension that she should get?

Mr. Macgowan: We would project him through from age 30 to 65 at his current earnings and determine what his pension would have been, and then provide the widow with, say, 50 per cent of that amount.

The Chairman: You say this would have to be a matter of—compulsion or permission in legislation, if the money is to come from the employer?

Mr. Macgowan: It would be permission as far as the legislation is concerned, and then the employer could make up his mind whether he wanted to provide that benefit or leave it out.

The Chairman: If it were just permission and the employer could decide whether he would do it or not, legislationwise it does not pose any tax problem; but the income to the widow would be taxable.

Mr. Macgowan: That is correct.

Mr. Coward: The contributions to provide that income would be tax deductible. This is where the tax problem arises.

The Chairman: Yes. It seems to me what you require is one thing, permission in the legislation to do it—that is, for a company to increase the amount of its contribution that is deductible in this special kind of case.

Mr. Macgowan: That is correct.

The Chairman: All you have to do is "sell" the employer to do it. You are not affecting the tax revenues, are you? Yes, you are.

Mr. Macgowan: Yes, you are.

The Chairman: Yes.

Mr. Macgowan: Because it is costing the employer more to do it and, therefore, he is going to pay less tax.

The Chairman: And the widow is going to pay a little more income tax.

Mr. Macgowan: Yes.

Senator Lang: The same as putting the widow on the payroll, taxwise.

Mr. Coward: Except if this is done through a pension fund, then the employer has a tax deduction many years before the widow pays out tax.

Senator Connolly (Ottawa West): She would not pay her tax until age 65.

Mr. Coward: In the case of the widow, she would get it when the employee dies. But between the time the employer puts in the contribution for the employee and the time that he dies, there is tax deferment.

Senator Everett: If she puts the sum at the time he dies into a pension plan of her own, does she avoid tax at that time under the White Paper?

Mr. Coward: No, but she can defer tax a little further by putting it into her personal registered retirement savings plan, and she then does not have to commence the pension until age 70.

Senator Everett: If she were 55, what would she do? Would it be a lump sum paid to her?

Mr. Coward: No, it would be an annuity.

The Chairman: If she puts it into her own personal retirement savings plan, when she starts drawing out of that, it is income in her hands.

Mr. Macgowan: No, she defers the income and gets it as income in her hands, and she deducts it because she pays it into her registered retirement savings plan.

The Chairman: When it goes into her personal retirement savings plan. If she sets up a personal retirement savings plan and she is not going to draw on that until 70, she has to have something to live on in the meantime.

Senator Connolly (Ottawa West): You assume in that case she is going to be employed in the intervening years?

Mr. Coward: Yes.

The Chairman: If she draws on it right away, it is income.

Mr. Coward: Yes.

Senator Connolly (Ottawa West): And her limit would be $1,500. Would she be a member of a plan by the fact that she is a beneficiary?

Mr. Coward: An amount of almost unlimited size can be transferred from one plan to another. This is not an annual contribution that comes under the $1,500 rule. The entire reserve for her annuity can be transferred.

The Chairman: Are there any other questions? Senator Everett?

Senator Everett: Could we turn to the appendix for a moment? It seems to me the main point of your brief is that rather than relating the allowable deductions to the amount paid in, they should be limited to the amount coming out of the pension plan. You say that amount should be sufficient to fund a pension plan that is 75 per cent of the best five years' average paid.

Mr. Macgowan: That is correct.

Mr. Coward: Yes.

Senator Everett: That would be the annual amount that would be paid?

Mr. Macgowan: The annual amount of pension that the retired employee would receive.

Senator Everett: Have you any idea what sort of deductions would be involved in that? I do not know whether you could really answer that question.

Mr. Macgowan: It depends on the amount of the pension. It is just ordinary income at that point.

Senator Everett: You say you might agree to a maximum of that?

Mr. Macgowan: Well, I do not like to see any kind of a maximum. Politically, we had the feeling you will have to put some type of maximum on the amount of pension. If a maximum has to be put on, we outline the way we think it could be done, and this is based on something that is going to move as inflation, the cost of living, or what-have-you, goes up.

The problem we have now is that we started out in the early forties with contributions going into the retirement plan of $300 a year. That stayed constant until it jumped to $900 a year, and that stayed constant for some time until it jumped to $1,500 a year. That has stayed constant for some years, and if it was right ten years ago it is not right now. I have been expecting another jump because we have been sort of following those first jumps. They seemed to be about six per cent of a deputy minister's salary, and when that got too much out of line then it jumped.

The Chairman: Well, that is one yardstick, is it not?

Senator Everett: What is this "year's maximum pensionable earnings" that you use as a yardstick?

Mr. Macgowan: This is out of the Canada Pension Plan Act, and it is defined in that act as starting out at $5,000 and increasing by a cost of living formula.

Senator Everett: I am sorry, but I still do not understand what it is.

Mr. Coward: These are the earnings that are taken into account in the Canada Pension Plan and the Quebec Pension Plan. They are the maximum earnings on which contributions are required under the Canada Pension Plan Act.

The Chairman: The contributions are such as to produce a pension of $5,000 a year; is that it?

Mr. Coward: No, sir, the contributions are charged on your earnings up to $5,000 a year.

Senator Everett: Over and above that there is no charge?

Mr. Coward: Above that no contributions are charged. The $5,000, however, is escalated with the earnings index in the Canada Pension Plan, so you figure this year as $5,300.

Senator Everett: And your formula using eight times that amount results in the figure you give here of $42,400?

Mr. Macgowan: We could have said ten times, or we could have said anything. The principle is to try to relate it to that figure.

Senator Everett: You said eight times, and that came to the figure of $42,400. You feel, then, that the maximum pension should be 75 per cent of that...

Mr. Macgowan: No, 75 per cent of the best five consecutive years' earnings or $42,400, whichever is the lesser.

Senator Everett: So you are saying that the maximum pension should be roughly $30,000.

Mr. Coward: No, $42,000.

Senator Everett: Did you not say that the $5,000 is the amount upon which the contribution to the Canada Pension Plan is...

Mr. Coward: Yes, but we are saying the maximum pension—not the maximum earnings but the maximum pension—should be related to that index, and we suggest eight times. The reason for the eight times figure is that the guidelines of the Department of National Revenue at this moment specify $40,000. This is the limit as it is applied informally at the present time.

Senator Everett: So then there would be no past service concept under your new plan?

Mr. Macgowan: There could be.

Senator Everett: There would be no need for it, would there?

Mr. Macgowan: If you cannot make up the $42,400 in future service you might have to rely on past service to do it. It depends upon how long you are going to be in a pension plan as to how quickly you are going to build up your pension.

Senator Everett: I thought what you were saying was that the deduction that would be allowed would be that amount which would produce a pension equal to 75 per cent of the employee's best five years, or $42,400, whichever is the lesser. It seemed to me from the way that reads, that the deduction could be allowed in one year if you so choose because it is not related to the payment you make but rather to the pension you achieve. Is that not right?

Mr. Coward: No, sir. We have suggested that it must be spread over a period of years, and our brief suggests 25 years as a reasonable period. Otherwise very large sums—sums of several hundreds of thousands of dollars—could be paid for one individual, and he would then have a long time in which to find a way of getting the money out on a favourable tax basis. I believe the pressure on the tax system would be rather impossible.

Senator Everett: So then you have another safeguard, which is 3 per cent of the total earnings over a lifetime; is that right?

Mr. Coward: Yes, sir.

Senator Everett: Which equals your 75 per cent?

Mr. Coward: Yes.

Senator Everett: And therefore it creates a 25-year requirement?

Mr. Magowan: That is correct.

Senator Everett: You take up those 25 years under your plan by future service or past service?

Mr. Magowan: That is correct. The current guidelines, for your information, senator, are 2 per cent for a maximum of 35 years.

Senator Everett: That is, either past or future service?

Mr. Magowan: Yes. We are suggesting 3 per cent over 25 years to allow somebody who is not getting started until age 40 a chance to build up a decent pension.

The Chairman: Are you talking only about the employer's pension plan, or are you including in this what the integration with the Canada Pension Plan might produce on top of what the private pension plan would produce?

Mr. Magowan: Yes, we are counting the Canada Pension Plan and the Old Age Security payments completely separate from these proposals, the principle there being that the lower paid person is going to need every dollar he can get, while with the higher paid person the O.A.S. and the Canada Pension Plan pension—the higher the pension the man is getting then the smaller the percentage of these two.

Senator Carter: I am not clear on that point. When you are talking about your plan are you talking about a separate plan, or are you talking about one that is integrated with the Canada Pension Plan?

Mr. Magowan: We are talking about a pension outside of the Canada Pension Plan. Most plans would be integrated, but we are

talking of maximums outside the Canada Pension Plan.

The Chairman: I suggest that Mr. Gilmour can clarify this. He has heard the discussion. Would you do that, Mr. Gilmour?

Mr. Gilmour: Gentlemen, in our present income tax procedures the main emphasis is placed on limiting the amount that the employee and the employer can contribute to a pension fund. Of course, these limits placed on these two parties automatically impose a ceiling on what can be paid out. You see, at the present moment, the employee can deduct up to $1,500 for the current year's service rendered by him. An hourly paid man who may be covered by a pension plan will probably not have withheld from his salary more than $1,500. The chances are that it will be less, and there is no provision whereby he can change this. Thus, each individual has a limit placed upon him.

Senator Connolly (Ottawa West): Each year?

Mr. Gilmour: Yes, each year, and that maximum for current service is $1,500. That limit has not been changed for a long time, so that there is a progressive limitation being placed on the employee's contribution as inflation takes over.

In addition to that, if an employee has rendered service to this employer in past years he is able to contribute another $1,500 for the past service to that employer. Consequently, if you have a man who has been with an employer a fair length of time, he is covered for his current year, and then if he wants, in effect, to cover past years he can deduct a further amount up to $1,500, so he can contribute a maximum of $3,000 to his pension plan today. The employer also gets a deduction. The employer's deduction for current services of his employee is a maximum of $1,500 for each individual employee, but there is no averaging whereby the whole payroll or number of employees is multiplied by 15. Rather the amount the employer is allowed for each employee is based on the percentage of the contribution to the fund. In other words, it would be $1,500 for the higher paid executive and it might be $100 for the office boy. So again the employer gets a current service deduction of a strictly limited nature. These limits of $1,500 go back a long way.

There is a further provision for the employer that if he obtains an actuarial certificate which states that the assets of the fund itself require to be augmented in order that they will be adequate, the employer can make special payments into it. He is not under any direct compulsion if there is a deficit in the fund to pay the whole amount in one year. The old rule was that if he did that he could amortize it over a 10-year period. Today, whatever the employer can pay in order to fund the pension plan, he can deduct in the year in which he pays it. Of course, all employers are not necessarily that wealthy and many of them will have to fund these special payments over quite a period of time. However, we come back to this, that there is a strict limit on the amount of pensions that most funds can pay.

There has been a certain amount of abuse such as in the case of a pension fund for a closely-held corporation where suddenly the shareholder executives become entitled to rather generous pensions. Consequently, of course, there have been deductions accordingly. The White Paper says that there has been a lot of abuse. There has been some, but I do not really think it has been that great, because it has been in the few closely-held companies that any worth-while tax collector could put his finger on in five minutes, and there are some worth-while tax collectors, I might add.

Senator Hollett: Still?

Mr. Gilmour: Still, sir. However, generally there are very definite limitations. Under many pension plans as they exist today there is provision under certain circumstances that if an employee who is otherwise pensionable dies in harness, perhaps 50 per cent of his pension is paid to his widow. There are many such provisions, but in rising inflation you are faced with these monetary limitations that are putting an ever-growing level on the pension that could be paid.

As I understand the brief presented by these gentlemen, they are recommending the perfectly practical idea that the emphasis in our Income Tax Act be placed on the pay-out of a pension plan rather than upon our present concept, which is a limitation on the paying-in to the pension plan. Our present concept encounters the fact that with inflation these maximum deductions allowed to employers and employees automatically limit the out-go of the plan. Of course today, with the Canada Pension Plan or the Quebec Pension Plan, that portion being government, almost every employer pension plan covers only the area in excess of the Canada Pension

Plan, which again reduces the load on the employer. The suggestion before us is a workable one if the employers can afford to fund it, that the limitation and the emphasis be placed on the out-go from any employee pension plan rather than upon the intake. The White Paper, of course, has been silent on this. The suggestion is really more in the nature of an amendment to our present laws than a criticism of the White Paper.

The Chairman: That would deal with the situation where a right to a pension accrued at any time before the age limit was reached; is that right?

Mr. Gilmour: Yes.

The Chairman: It would deal with two situations: health retirement before the maturity and the widow's portion in the event of death before maturity in the plan.

Mr. Gilmour: Yes. In that respect the White Paper does contain proposals. At the present time if a man retired for reasons of health before reaching a pensionable age, or died, so that there was a funded portion payable to his estate, the law provides that this single payment may be set aside from the income of the year if so decided. Instead a special tax based on the average rate of tax paid in the immediately preceding three years is applied to the payment. The full cumulative rates of our graduated taxes are not invoked. Often when a man has had to retire because of ill health, taking his pension, his income for the preceding three years may have been low. In that case there can be a real benefit to the man himself. The White Paper proposes to do that we have had for about 20 years in our Income Tax Act. Instead it proceeds to introduce a so-called averaging procedure that I think is completely unworkable for a retired person today, because it requires that the income for a year must be $33\frac{1}{3}$ per cent greater than the previous income, and then there is a very complicated averaging procedure. This might be fine for a professional athlete, a boxer or somebody who rises quickly and then goes the other way, where the one-third averaging arrangement will probably work. It will not accomplish anything for, say, the rising professional man, because with a little bit of luck the averaging rising lawyer will have more than one-third, or perhaps less. In such a case this averaging does not work out too well.

This averaging will hurt very badly the widows, the retired men who have to take their pension, or the unfortunate chap who dies before he has reached pension age, and there is a very real criticism of that White Paper proposal.

For the ordinary pension fund, the White Paper is not very explicit on anything. Consequently, in looking ahead to arranging pension plans in Canada, the suggestion these two expert gentlemen are making may be very workable for future employee pension plans in Canada. This is not White Paper; this is forward thinking on income tax.

Senator Isnor: Is there any restriction on investments?

Mr. Gilmour: Yes, there are very many restrictions in practice. Probably the primary one is that the assets of the pension fund must be invested in Canadian securities. At the moment, about 90 per cent of the investments must be in Canadian securities. Of course, this was brought in, I guess, for two reasons. First, to try to keep these funds in Canada so that the pensioner would be protected; secondly, I guess it was also designed to try to help the Canadian markets for securities. In the United States the investments of these pension funds, either the union funds or the employer funds, have become huge amounts, and they can have a very great influence on the market price of securities. We have therefore held our investment of Canadian funds to Canadian securities. There is a further restriction, that the stock of your own company cannot be put into the fund, which again is, I guess, a very reasonable protection for the employee, because there have been abuses in that respect.

Senator Isnor: How long has that restriction on investing in your own organization been effective?

Mr. Gilmour: About five years, I would say.

Mr. Coward: May I suggest, Mr. Chairman, that up to 10 per cent of the fund can be put into the securities of your own company. Not more than 10 per cent of the assets may be invested in your company, but you are allowed 10 per cent.

Mr. Gilmour: How long has that been in force, do you recall?

Mr. Coward: It came in with the Pension Benefits Acts, or shortly thereafter. Ontario had the first Pension Benefit Act, which commenced on January 1, 1965.

Mr. Gilmour: Roughly five years.

The Chairman: Can we pick it up from there?

Mr. Coward: I find myself in admiring agreement with Mr. Gilmour's statement. I should like to be quite clear on one thing. He mentioned that if a member of a pension plan dies his widow can receive 50 per cent of his pension. Under the present law the widow can receive only 50 per cent of the pension that has been earned for this man in respect of his service up to the date of death, not the pension he would have received had he been able to work through until retirement age of 65. This is the big difference. We feel that it would be a major advance if widows' pensions of 50 per cent or 60 per cent of the man's expected ultimate pension could be provided for the widow instead of 50 per cent of what he had earned up to date.

Mr. Macgowan: I should like to amplify one other thing that Mr. Gilmour said. He mentioned 90 per cent of the investments in funds now are basically Canadian. The limitation right now is that not more than 10 per cent of the income of the fund can come from outside Canada. A lot of funds are down to 70 per cent, or maybe even 65 per cent, in Canadian securities because they have low yielding growth stock from the U.S. or Europe. The White Paper proposes that that be changed to 90 per cent of the assets, so there is a substantial change proposed in the investment field for pension funds.

Senator Laird: Which do you prefer?

Mr. Macgowan: We are pension specialists, not investment people. I feel that this is a political decision. I would certainly like to see complete freedom for people to invest wherever they wanted to.

Senator Connolly (Ottawa West): Including the company that contributes?

Mr. Macgowan: With the 10 per cent limitation in the Pension Benefits Act.

Senator Connolly (Ottawa West): You would change that limitation?

Mr. Macgowan: Yes, sir. There are Pension Benefits Acts in four provinces now.

Mr. Coward: And in employments under federal jurisdiction.

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Mr. Macgowan: There are literally no investment restrictions in the other provinces. The Department of National Revenue does not have any investment restriction on pension plans, other than that they must comply with the provincial acts if they are in effect.

Senator Hays: What provinces?

Mr. Coward: Ontario, Quebec, Alberta and Saskatchewan.

Mr. Macgowan: You are safe, senator!

Senator Hays: Yes. I was worried about that.

Senator Haig: Forward looking.

Mr. Coward: Plus all employments under federal jurisdiction, which covers not only the Territories but a very wide range of employments.

The Chairman: You were talking about the widows, that you required something permissive in legislation so that employers may contribute additional moneys which would be deductible for tax purposes, so as to raise the widow's benefit immediately.

Mr. Coward: Yes, sir.

The Chairman: Related to what the employee might get had he survived until the maturity of the plan for him.

Mr. Coward: That is correct.

The Chairman: Now the other matter, Mr. Coward.

Mr. Coward: The other area with real significance is that there are other circumstances under the present law in which double taxation can occur. We would like to see the legislation written so that this does not happen. One example is if the pension plan provides for certain percentage contribution from families and the salary from the senior man rises so his contribution is more than $1500. The excess of $1500 is paid from after tax income, but the pension that that excess produces would be taxed again when he receives the benefit. This is a case of double taxation.

Mr. Macgowan: One other case of this double taxation would be for employees in Air Canada or C.N.R. who are working in the States. They pay in to the Canadian pension plan but cannot deduct the contribution from earnings in the United States. They move

back to Canada and the pension or the death benefit or termination refund is fully taxed here. This is particularly difficult in the termination refund which is really their own money they are paying tax on. When they come back to Canada and get a refund they have to pay tax on it again. This is an example of two areas of double taxation.

The Chairman: Is there anything else?

Mr. Coward: I was not sure whether I was to include, as an example, of double taxation, the dividend tax credit. The White Paper proposes that there be no dividend tax credits through a pension fund. The pension produced by these moneys will of course be taxable when paid to the individual and one could therefore consider that there is double taxation, the taxation on the corporation.

The Chairman: The pension fund itself does not pay any tax on its revenue.

Mr. Coward: They are all included in the benefits sooner or later in which ultimately tax is paid.

Senator Everett: Mr. Chairman, before we leave this point, on item 9 of page 3 of the appendix they talk about a surtax of 50 per cent being imposed where the pension exceeds the 75 per cent limitation. Doesn't that presuppose that the employee got a deduction in excess of the amount that was allowable?

Mr. Coward: Yes, and it reflects the fact that the interest earned by the contribution would not be taxed during the deferred period.

Senator Everett: Why wouldn't you disallow that amount?

Mr. Coward: Because in many cases it is very difficult to determine the amount. The pension depends on future salaries and it is very difficult to determine what contribution is applied to particular individuals. Pension plans are funded on a pool basis. Money is not allocated to individual accounts. Some employees will quit the service and it will be savings, whereas some will die and there may be gains or losses. It is the termination that is very difficult.

Senator Everett: This then is a shortcoming of the deduction related to eventual pension where there is a maximum amount.

Mr. Coward: Yes.

Senator Everett: There is no other way of getting around it, such as imposing a surtax?

Mr. Coward: There are rather alternative ways, but this seems to be the most simple.

The Chairman: We now have another brief. This is a brief which you have before you and deals with pension plans and profit sharing plans. Mr. Coward is going to talk to us about this one.

Mr. Coward: May I first introduce Mr. O. B. Mabee, Vice-President, Personnel and Public Relations, Simpsons Limited; Mr. F. R. Southmayd, Vice-President of Finance, Simpsons Limited and Mr. T. VanZuiden, Treasurer and Assistant Secretary, Dominion Foundries and Steel Limited.

This brief was prepared by Mercer as a result of meetings and discussions with companies that operate profit sharing plans. It is not presented on behalf of these companies since some of them are submitting their own briefs, but it is endorsed by the companies whose names appear in the brief. I may say that we have had access to a lot of data and information. We concentrated our work on one issue only, which is the taxation of lump sum payments from pension plans and profit-sharing plans. I think a word of explanation is needed. Profit-sharing is a term that is used rather loosely and some plans provide benefits related to profits or registered as pension funds and still provide lump sums. Others are registered as the third profit-sharing plans under section 79(c) of the Act. They have this in common, that lump sums may be paid with the option of the employee and in practice, in 99 per cent of the cases a lump sum is taken. These lump sums allow the option under section 36 being taxed at the average rate of the last three years which was explained by Mr. Gilmour. The White Paper proposes that withdrawals from pension plans will no longer be taxed at the average rate of the last three years, but will be taxed as ordinary income subject to the averaging provision in the White Paper. I may say that this averaging provision, as applied to someone who is just retiring, is of very little assistance. You can only average backwards and all our examples indicate that it is not very helpful.

The Chairman: If you take the averaging of the previous three years to retirement it is not likely in those three years that there would be much change unless there was a windfall. Your average might be whatever income or tax-wise it was in one of those

years. If a man was drawing a salary of $12,000 a year that salary may have been constant in the last three years.

Mr. Coward: Yes, but if he receives a lump sum of, say, $20,000 this is rated on the $12,000 he has been receiving.

The Chairman: On the year of retirement?

Mr. Coward: There is a rather complicated formula in the White Paper by which you add a third to his regular income and that gives you 16,000, the additional 4,000 is spread and taxed. It is a formula that I would not like to have to explain in a moment. Our example shows that it does help a little, but not very much under those circumstances.

The Chairman: I would not think it would very much.

Mr. Coward: In a typical case.

The Chairman: What if I divided the lump sum payments. I could then control my marginal rate.

Mr. Coward: If you were allowed to spread forward, as was proposed by Carter, you would have a much more satisfactory averaging system.

Mr. Gilmour: There is a different view in the present act.

The Chairman: I agree. But is this a method that you are suggesting?

Mr. Coward: I am suggesting, very briefly, two things. Number one, we are suggesting that the three year averaging, for lump sum payments, be retained, with section 36, that you continue the present system which has worked pretty well for more than 20 years.

Secondly, we are suggesting that if any change is forced, in this particular matter, it should not be retroactive to the benefits that have already been accumulated in the funds. I think it would be most unfair if an employee, who was expecting to retire in a year or two and expecting his tax to be at the rate of 15 per cent, found that his tax was at 30 per cent, by a change in the act.

Senator Isnor: What does Mr. Mabee think of that? I understand your company has quite recently made changes in its pension plan?

Mr. O. B. Mabee, Vice-President, Personnel & Public Relations, Simpsons Ltd.: We have been with a profit sharing plan since 1919. We are most concerned that, this coming Monday, both Simpsons Sears and ourselves are going to have a profit sharing meeting with our profit sharing members, who carry 99 per cent of our regular employees. We are going to have to face them with this White Paper proposal that upon retirement, the tax which the Government will extract will be approximately double than what they would expect under the present system. We have to tell them that and we have, between us, 23,000 members in our profit sharing plan. Mr. Gilmour very lucidly explained what would happen and how unfair this was, and Mr. Coward followed that up with his explanation.

Senator Isnor: Is it true that you have already indicated to your employees they are likely to have an increased pension benefit?

Mr. Mabee: No, sir, no. I do not know where you got that information. Our company this year is putting more into the profit sharing than ever before, if this is what you mean. Our contribution this year is the largest ever.

Senator Haig: Are you putting it in in cash or in shares?

Mr. Mabee: We have an investment committee. It is in Simpsons shares and in other shares. We are regulated by this 10 per cent of our own company stock. But the employees are the shareholders, every one of them. I cannot speak for Simpsons Sears, but I think that in Simpsons the number of shares controlled by employees in the profit sharing funds is about 8 per cent of the shares. When they leave us, as Mr. Coward indicated, they have the option of buying an annuity with what they have to credit, which is the balance, with the cash and the shares, they could buy an annuity, and avoid this lump sum tax. But 99.9 per cent of them take out their cash and shares—Simpsons shares—and they invest it wisely, and they can do better than buy an annuity. This is really why they do it.

Over many years, I can only think of about three people who bought an annuity with the balance of their profit sharing. They would like to have it with them—their cash and Simpsons shares.

Senator Isnor: Roughly speaking, what percentage of your annuities are invested in your own companies?

Mr. Mabee: We are within the law, 10 per cent is the law.

Senator Isnor: Would it be 8 per cent?

Mr. Mabee: No, around 8 per cent of the shares, Simpsons shares, are owned by the profit sharing plan and divided amongst the employees, the outstanding Simpsons shares.

The Chairman: Have you anything further to add?

Mr. Coward: There is very little more to say. We think there is an extremely strong case.

The Chairman: Is it your suggestion, then, that section 36 be retained and that is the answer to all your problems?

Mr. Mabee: Yes, we think it would be the answer.

The Chairman: Certainly, on the basis of the principle that you should not change the rules after the game has got under way, there would seem to be a logical justification for retaining the rules under which you have brought these things into being. What the future after that should be, I suppose is a matter of Government policy. But at least you would know the rules and would not have to play the game if you did not like them. Are there any further questions?

Senator Lang: I would like to ask the witness, apart from increasing tax revenues, from your experience of these pension plans can you see any rationale behind the proposals in the White Paper?

Mr. Coward: With respect to pension plans, yes, I think that there is a rationale behind the White Paper proposals.

Senator Lang: How would you define that, how would you elucidate it?

Mr. Coward: I am not sure which ones.

Senator Lang: Let us take it on the profit sharing plans, the matter of taxing a lump sum payment as income under a formula rather than using the averaging provision. Is there any reason for that sort of proposal in the White Paper, other than to increase the revenue of a department?

Mr. T. VanZuiden, Treasurer & Asst. Secretary, Dominion Foundries & Steel Ltd.: May I comment on that? Perhaps there are two reasons why it is proposed to be discontinued in the White Paper. One, the so-called top hat profit sharing schemes which Mr. Gilmour has already referred to, which he suggested any tax collector worthy of the name would be able to put his finger on in five minutes. We believe that, to the extent that this represented an abuse it has already been stopped. Secondly, it is perhaps felt that the concessions—for lack of a better word—that one has under section 36 is an advantage that they are really not entitled to, just because he happens to be a member of a profit sharing scheme instead of an ordinary pension fund under which he would not be entitled to get a lump sum.

In Dofasco's Case we have had this profit sharing arrangement for 30 years and it really represents the only source of retirement income for our employees, and we have 5,700 members in it, and it is their pension fund. For the most part they take a lump sum when they retire.

The Chairman: It is their method of saving.

Mr. VanZuiden: It is really their retirement plan.

Mr. Mabee: It is forced saving.

The Chairman: Yes.

Mr. VanZuiden: May I read the section out of the booklet which we give to our employees?

The Chairman: Yes.

Mr. VanZuiden: This is a booklet which each member gets when he becomes a member—this is Dominion Foundries Steel Limited:

> The Federal Government's proposals for tax reform, as summarized in the White Paper, will, when they become law, increase the tax on lump sum withdrawals from the Fund or New Plan. For example, a married man with no dependents, earning $9,000 a year, who retires from the Fund with $45,000 and takes a cash payment...

Incidentally, we have a good number that have built up this sort of credit. Under the present law he will pay a tax of $8,300 on this lump sum, whereas, if the White Paper proposals become law he will pay a tax of $15,800. So that is an additional $7,500 out of his retirement money.

Senator Cook: Have we any estimates at all what this would mean over-all? How much

increased revenue would come from this change?

Mr. VanZuiden: I understand that the effect on the revenue is practically negligible, that the tax that is being extracted now under the provisions of Section 36 would be roughly equivalent to what the tax would be if it was collected from annuity income.

Mr. Coward: Perhaps I could make the remark that Section 36 was amended recently to prevent certain abuses and that the maximum that can come under that rule is now $1,000 multiplied by the number of years of service, and since action has also been taken against these so-called top-hat pension plans and shareholder plans, the abuse in Section 36 has, in my opinion, been removed.

Senator Everett: Would you amplify on that $1,000?

Mr. Coward: Yes. The special tax rate, which is the average of the last three years, can only apply to the amount of refund or $1,000 multiplied by the number of years of employment with the company, whichever is less, and the excess is taxed as ordinary income.

Mr. Mabee: There is a limit.

The Chairman: Can the profit-sharing plan and the pension plan exist in the same company?

Mr. Coward: Yes, sir.

The Chairman: Now, we have been talking about what the effect of this change in the law on lump sum payments under a profit-sharing plan would be, but the White Paper proposes to apply the same rule to the pension funds in the pension plan. Is that right?

Mr Coward: Yes, sir.

The Chairman: If I could commute my pension, if the plan permitted it, then I would be interested in my right to average.

Mr. Coward: Yes.

The Chairman: To that extent, it would apply in both cases.

Mr. Coward: Most pension plans have only very limited rights of commutation.

The Chairman: I see. Then the approach on taking away this right to averaging is on a different basis than it would be in the two cases. In the case of the profit-sharing plan, the theory must be that, well, you are using money and investing it and, therefore, you should be subject to the same tax risks as anybody else who does that.

Mr. Coward: The pension plans using the profit-sharing principle that we have been talking about mostly were written before the profit-sharing legislation existed, before deferred profit-sharing plans were introduced, and they perhaps, by special arrangement with the tax department, do provide for lump sums. This is why there is a somewhat confused situation. They, however, have the same characteristics: the payments are related to profits; the payments may be in the form of a lump sum.

Senator Everett: Are they subject to the same limitations as the pension plan with respect to the payment of the $1,500?

Mr. Coward: Yes, they are, with some slight variations.

The Chairman: On that basis I suppose you would call it an additional pension provision.

Senator Everett: Does that mean the amount credited to the plan cannot exceed $3,000 a year?

Mr. Mabee: For each individual, yes.

Senator Everett: And under the White Paper, will it allow you to purchase an annuity and bring in the income as the payments on the annuity are made? In other words, deferring of the lump sum into an annuity?

Mr. Coward: Yes, it can be done by the transferring of the registered retirement savings, and most kinds of annuities can be purchased direct through the plan.

The Chairman: These profits that are allotted to the profit-sharing plan are after tax profits, aren't they?

Mr. Mabee: They are before tax. They are a percentage of net profits before tax, and we are currenty contributing 10 per cent into the profit-sharing plan and into the Canada Pension Plan.

The Chairman: Where do you get your exemption? Let us assume your company's net profits before taxes were $5 million and you contributed 10 per cent of that.

Mr. Mabee: To the profit-sharing plan and to the Canada Pension Plan?

The Chairman: Yes, where does your right to exemption from corporate tax under that contribution spring from?

Mr. F. R. Southmayd, Vice-President of Finance, Simpsons-Sears Limited: Well, it would be the same as if it were contributed to a pension plan. We have to be careful that the contribution with respect to any particular employee does not exceed the limits of $1,500, and so on, that we were talking about.

The Chairman: What you are really doing is using the reduction privilege in the Income Tax Act in relation to pensions not only to take care of a pension plan but also to take care of a profit-sharing plan, and that is why you use net profits before taxes as a basis for determining it.

Mr. Coward: Either you can register your plan as a pension plan, in which case you say it applies, or you can register it as a deferred profit-sharing plan, in which case there is a very similar tax deferment.

The Chairman: Right. I wanted to clarify that.

Senator Hays: Could you give us some examples under the White Paper and some as it is now? For example, you could use a man earning $6,000, $10,000 and $12,000.

Mr. Mabee: I believe you will find what you are looking for on page 3 of the brief, senator.

Senator Hays: Thank you.

Mr. Coward: Yes, the company provided a range of that type.

Senator Haig: Mr. Chairman, I understood the witnesses to say that their company put in 10 per cent of net profits before taxes. Is that right?

Mr. Mabee: Yes.

Senator Haig: What does the employee put in?

Mr. Coward: He puts in towards the Canada Pension Plan and the profit-sharing plan 5 per cent of his earnings, up to a maximum of $500 under the profit-sharing plan.

Senator Haig: So his contribution does not fluctuate with your profit picture?

Mr. Mabee: No.

Senator Haig: Thank you.

Senator Everett: Can the company's contribution to any one employee exceed $1,500?

Mr. Coward: No. Not under a deferred profit-sharing plan. Under a pension plan they can use this provision for making up liabilities as was previously mentioned.

Senator Everett: I am talking about the deferred profit-sharing plan.

Mr. Coward: No.

Mr. VanZuiden: I would have one further comment to make with respect to the question raised about the rationale behind this, Mr. Chairman. I would raise the question as to whether it is a matter of philosophy on the part of the authors of the White Paper proposals that an annuity would be more advantageous than a lump sum payment to a retired person, perhaps because it is felt that a person is not capable of dealing with large sums of money. However, we follow our retired people very closely and we have never come across any cases where they have squandered their lump sums.

The Chairman: As an alternative to a policy of going ahead regardless, it would appear that there should be a transitional period, because what you are doing is provided for under an existing law that has been in force for some time. Therefore there should be a phasing out or a transitional period where you can get on base again, and those who want to convert and take a lump sum payment—would they have the privilege at any time under the profit-sharing plan or is it a maturity date?

Mr. VanZuiden: They take it when they retire or leave.

The Chairman: That means that if I want to anticipate possible legislation, I would have to go through the motions of leaving and completing this transaction and then being rehired.

Mr. Mabee: Unless we change the rules.

Mr. VanZuiden: Our own people got quite excited after reading this little booklet. And now they are worried because when a person reaches retirement age he wants to do what he pleases with his money.

The Chairman: That's right. Thank you very much, gentlemen.

We have one more brief from The Royal Architectural Institute of Canada and we have a number of representatives here. We

have Mr. W. G. Leithead, President, Mr. C. F. T. Rounthwaite, Honourary-Treasurer, Mr. W. A. Salter, Director of Professional Services, Mr. J. P. Nelligan, Company Solicitor and Mr. E. L. H. Burpee, the Company's Auditor.

Who is to be your spokesman?

Mr. W. G. Leithead (President, The Royal Architectural Institute of Canada): I am.

The Chairman: Will you present your panel to the committee?

Mr. Leithead: Mr. Chairman, honourable senators, on my immediate right is Mr. Rounthwaite, our Honourary-Treasurer, and next to him is Mr. Nelligan who is our Institute Solicitor, and Mr. Wilson Salter, our Director of Professional Services. Unfortunately Mr. Burpee is not with us because he had to leave before lunch.

In the brief we have tried to be as concise as possible and to deal only with those things which affect the profession directly. We are the, shall we say, co-ordinating body for a number of component provincial associations. Most of these associations will be putting in their own briefs, because they are autonomous bodies. We can inform you, however, that the Province of Quebec Association subscribes to this brief and they will not be putting in a brief of their own and I think the only other Association not putting in a brief will be the Architects' Association of Saskatchewan.

We are concerned with items in the White Paper which affect construction development, the health of the construction industry and we presume that these will be covered by other submissions.

The Chairman: In my view you have a very important item there, the accrual basis for computing taxable income.

Mr. Leithead: This we feel is a very difficult for us because of the duration of time the, shall I say, peculiar nature of our business. At the moment we have the opportunity of reporting income either on a cash basis or on an accrual basis. The accrual basis is difficult for us because of the duration of time involved between the initiation of a project and the carrying through to the completion of our work, and it is not unusual, for example, for a hospital, to take seven or even ten years. The accrual system of accounting suggests that we should be paying tax on income which has actually not been received by us but which presumably we have earned by means of material that we have produced. But we find that it is virtually impossible to put a true valuation on this work or to indicate when we will receive our fees in many cases, and this applies in particular to institutional work or school work or I might say work for the various levels of government.

The Chairman: You are talking about work that has been done but not billed for?

Mr. Leithead: Yes, sir.

The Chairman: And the proposal here on the accrual basis would be that work done, time spent and not billed for should be valued and included as income in the year in which you do it?

Mr. Leithead: That's right.

Senator Connolly (Ottawa West): Whether or not you have already been paid money.

The Chairman: I said not yet billed for.

Mr. C. F. T. Rounthwaite, Honourary-Treasurer, the Royal Architectural Institute of Canada: Mr. Chairman, this is the point. You may be in no legal position to demand payment. For example, a 50 per cent completed set of working drawings, as far as your client is concerned, is completely valueless, and you may have been two years on the road with a staff of 10, and you may have another six months to go, and so you cannot bill. So if there is to be a method set up, then I think the entire profession from coast to coast will have to change its method of collecting accounts. Some system of monthly time-card payments would have to be initiated and this will affect all levels of government and the private sector.

The Chairman: I suppose even government contracts that you may even perform services in relation to operations on the same principle?

Mr. Leithead: Very much so.

The Chairman: They don't pay for the work until it is done.

Mr. Rounthwaite: More than that, they frequently withhold payment for up to a year after you have submitted your account even though they are not disputing the account.

Senator Laird: Do you ever ask them for retainer fees before you start the work?

Mr. Leithead: Most of our work is done on a fee basis.

Senator Laird: But I mean a retainer fee in the sense that a lawyer means.

Mr. Leithead: You mean money in hand?

Senator Laird: Yes.

Mr. Leithead: No, sir.

Senator Laird: Do some of your people do that?

Mr. Leithead: Not to the best of my knowledge.

Senator Laird: You have a choice at the present time whether to go on to a cash or accrual basis.

Mr. Leithead: Yes.

Senator Laird: Do you know whether or not any other profession has changed the accrual basis?

Mr. Rounthwaite: My firm amalgamated with another firm a few years ago. They had always been on the accrual basis, and as you know you cannot change from one to the other without the Minister's consent. When this marriage took place, my old firm having been on the cash basis—it was an opportunity for them to keep the cash basis with us, but we keep our accounts like most firms, and the manual for architectural accounting which was prepared by the Ontario Association which is more or less standard for Canada suggests that for management purposes, accrual accounts be kept regardless. There is another aspect that comes into this, and that is that you are like the prairie farmer who looks out the window and the crop looks great, but that night there is a hail storm. This is what happens. You may have a very large job and you might be anticipating a certain fee in return. Then the client says, "The Hospital Services Commission have cut back on grants. We are not proceeding," and it is frequently a question of negotiating a settlement, but what you may have anticipated and reported in your accrual accounting could become meaningless, in fact, when a settlement is arrived at. In almost every instance concerning government departments, termination results in a negotiated settlement.

The Chairman: Is your arrangement, or the agreement under which you carry on business, drawn in such a way that in such events you have a right to some amount of money at that time?

Mr. Rounthwaite: The agreement, Mr. Chairman, presumes an on-going situation, a completed program project. It makes reference to recovery of your out-of-pocket expenses and costs if termination should happen between several of the defined points wherein the fee or part of the fee becomes available. Let us say that preliminary work has been done and paid for; that 25 per cent of the working drawings have been prepared. These are of no value to a client should he stop your work. So, generally speaking, you are anticipating that this will be a matter of trying to collect your in-house costs and your out-of-pocket expenses.

Mr. Leithead: It is a rather difficult discretion.

Senator Haig: Mr. Chairman, if a contract is not cancelled and you have prepared your drawings, do you get a certain fee after a certain period of progress?

Mr. Leithead: Yes, sir. Associations vary, but generally speaking at completion of 20 per cent of the work or at the end of sketch drawings; at the end of working drawings, that is just before going out to tender; and then periodic payments as the job is under construction.

Senator Haig: The architect certifies to the owner that a certain amount of work has been done, and a certain amount is to be held back on the architect's fee based on that work done?

Mr. Leithead: Yes, we indicate to our client that in our opinion we have completed satisfactorily that portion of the work, and once we have received his recognition that he agrees, then we bill him on that basis.

The Chairman: On what you bill, operating on your cash basis, do you bring that into your income?

Mr. Leithead: Yes.

Senator Hays: What is your spread, if on a cash basis? How far back and forward do you go?

Mr. Leithead: Just the one year.

Senator Hays: To give you an example, suppose that you are building a library for

the City of Edmonton and the mayor says, "I want you to go ahead. I can sell this to the council. If we do not go ahead, then you are out of luck", how do you handle that account?

Mr. Leithead: We do not enter into agreements of that nature.

Senator Hays: Some architects do.

Mr. Leithead: I am afraid some have, yes, but...

Senator Hays: This is frowned upon?

Mr. Leithead: Very much so.

Senator Hays: How would they handle it?

Mr. Leithead: Who?

Senator Hays: How would such a firm handle this?

Mr. Leithead: They would just have to suffer that loss.

Senator Hays: But it was an actual expense of $15,000, say.

Mr. Leithead: This happens, I may say, in the case of competitions, where the mayor might choose to say, "I want an architectural competition," and we supervise these competitions—that is, the Architectural Institute does. Firms are then permitted ethically to submit schemes, and if they do not happen to win the prize that is just money they have risked with the hope of winning it.

The Chairman: It would be a deductible expense to the extent that it would be regarded as money laid out for the purpose of earning income.

Mr. Leithead: Yes.

Senator Lang: Mr. Rounthwaite mentioned the merger of his firm being on a cash basis with another firm on an accrual basis. A firm such as that on an accrual basis, would it carry into its income its unbilled inventory of work, or just its accounts receivable at the end of each year?

Mr. Rounthwaite: All jobs are assessed on an accrued value net asset basis.

Senator Lang: You could run an accrual basis...

Mr. Rounthwaite: But in effect the accrual in time should become fact.

Senator Lang: What I am saying is, I assume you could operate a professional office on an accrual basis, but not include your unbilled inventory of work but merely your accounts payable.

The Chairman: Accounts receivable.

Senator Lang: In other words, work billed but not paid for.

Mr. Rounthwaite: Yes.

Senator Lang: You would still be on an accrual basis, would you not?

Mr. Rounthwaite: Yes, but there is another thing that comes into this. A wealthy firm can afford an accrual system, if they have a lot of working capital, more easily than the smaller firms. The average American firm consists of 6.2 peope. We think we represent about 1,000 Canadian firms with, possibly, an average of five people in each. If you have to carry work for a considerable period of time, and your major jobs will often have carrying periods of one, two or three years, you need a tremendous amount of working capital. If you are going to pay tax on an accrual basis you need even more.

Senator Lang: You have no objection if what the White Paper meant by an accrual basis—and obviously it does not—if an accrual basis merely meant you carried into your income your billed work that you have not been paid for and you did not carry into income your unbilled inventory on work. That would not be an onerous requirement?

Mr. Leithead: Yes, I think we could accept that.

The Chairman: You mean to bring accounts receivable into your accounting.

Senator Lang: But not your unbilled inventory of work.

Mr. Rounthwaite: In that case your vast expense, because of the result of highly paid technicians and assistants, could even be marching ahead of a positive balance of anticipated income. If your office was very busy and you were using that system, you could run two or three years, probably, showing with your salaries, rent, consultants and all the rest of it, that you had no income.

Senator Haig: No dollars coming in.

Senator Burchill: Would not that amount of unbilled inventory come into your next year's

returns? It would come in eventually, would it not?

Mr. Rounthwaite: Yes.

The Chairman: But why should you pay before you get it?

Senator Connolly (Ottawa West): I suppose if you are paying on an accrual basis, you cannot always be sure that the accounts that you bill in that year will be paid. Some of them may be paid, but you will not know that until you actually submit them, and they may not be submitted in the year. You may have bad accounts in respect to which you have no remedy, I gather.

Mr. Leithead: Our billings are usually of the 90 or 120-day variety. We very seldom get paid within 30 days of the submission of an account. It seems that Canadians regard their architects in the same way as the English regard their tailors. But, there are firms—I know of a few in the United States—which operate on a monthly billing basis, but these are very successful firms that are dealing with very large clients, generally speaking, and they have been able to make these arrangements.

Senator Connolly (Ottawa West): It is an unusual arrangement?

Mr. Leithead: Yes, very unusual.

Senator Connolly (Ottawa West): You have talked mainly about the problems involved in work done in the public sector, but I suppose you could have big projects in the private sector—office buildings, high rise apartments, and that kind of thing—in respect to which you could have bankruptcies and failures.

Mr. Leithead: Yes.

Senator Connolly (Ottawa West): This could be the case especially if they are long term projects. What is your position if you are on an accrual basis and you are not yet in a position to bill your client, but the tax department requires you to pay the tax. You may not submit your bill until the next year, or the year after, and then in the meantime the project or your client fail. Then what you have done is pay taxes on something you never received.

The Chairman: What you are saying is that they may not physically have the money—they may have an account for it, but if they are on the accrual basis they will have to pay the tax. In the next year you may have a loss in respect of that item because there may be a bankruptcy.

Senator Connolly (Ottawa West): Yes.

The Chairman: Then your only benefit would be in the loss carry-back or carry-forward provisions in the Income Tax Act.

Senator Connolly (Ottawa West): But in that case they would have been out of pocket.

The Chairman: Yes.

Senator Molson: May I ask why it would not be possible for the Institute to set up its rules so that its members are protected. Its members could be allowed to bill regularly for a certain proportion of the work carried out. That is a reasonably common practice. Why would it not be possible,when thousands of dollars have been spent on plans, to be paid for a reasonable proportion of the work you have actually done for a client up to that stage. You say that half finished plans are no use to the client. That is perfectly true, but in the same way a half finished house is no use to a client, and neither is a half finished ship. I am wondering if the Institute itself could not improve the lot of its members in this respect.

Mr. Leithead: I think we are tending to get more of that sort of situation as we get more sophisticated in accounting principles. The reason why I was stressing work in the public sector is because many of our young architects who are with small firms, or who are just starting practice, quite often have schools as their first work. In many cases the school boards just do not have the money in hand to pay the architect. We do try to go along with that client, because we recognize the situation, but I agree, sir, that we have been somewhat lax as an association.

Senator Molson: A hydro commission would cut off the supply of power if its bills were not paid.

The Chairman: But the hydro does not have any competition.

Senator Molson: Lawyers get paid, do they not, Mr. Chairman?

Senator Lang: No, do not get that idea.

The Chairman: No, they have the same problem.

Senator Connolly (Ottawa West): Lawyers, accountants, and doctors face the same problems. A lawyer may start a case that will not finish for three or four years, although sometimes a lawyer can say: "I want a deposit, or a retainer."

Senator Cook: Sometimes?

Senator Molson: I am sorry, Mr. Chairman.

The Chairman: At least, you tried to make your point. Is there anything else you want to say on this point of the accrual basis as against the cash basis?

Mr. Leithhead: I do not think so, sir.

The Chairman: You have a number of items here such as entertainment and related expense.

Mr. Leithead: Yes, Mr. Chairman. Our profession, in common with other professions, is not permitted to advertise. There are very few firms whose work comes across the threshold without any attempt on the part of the members of the firm to obtain that work.

The Chairman: It does not come without a little promotion?

Mr. Leithead: That is right. So, there are few places where we can meet the people who are potential clients, and these are clubs—not necessarily just social clubs, but service clubs and chambers of commerce, et cetera. We have been allowed the privilege of deducting the membership fees as expenses, and we feel that this should continue because we cannot put advertisements in the daily newspapers. There is no other way by which we can expound on our sevices than by talking to people. We feel that a reasonable allowance for club memberships and entertainment, et cetera is quite justified.

The Chairman: And also convention expenses?

Mr. Leithead: Yes, but I should like to deal with conventions a little differently.

Senator Connolly (Ottawa West): Just after the war Mr. Howe addressed the senior golfers of Canada who were meeting at the Royal Ottawa. He said that he thought a lot of the things that were accomplished by the officials of the Department of Munitions and Supply during the war with outside people were accomplished on the golf course. This is a fact of modern life. What these gentlemen are saying, I think, is emphasized by the fact that they are not allowed to advertise, so there must be some other alternative.

Senator Isnor: Do you mean that they are not allowed to advertise at all?

Mr. Leithead: The only advertising that an architect can do is when a building has been completed and there is an anouncement in the press, he can put in a card of a designated size—designated by his local institute. The only other advertising carried on is that the Association itself may conduct an advertising campaign indicating in very valid terms the value of retaining an architect. Those are the only two forms.

Senator Laird: Are you not checked very carefully by the Department of National Revenue in the matter of expenses?

Mr. Leithead: That has been my experience.

Mr. Rounthwaite: Those of us who do business with others who enjoy private diningrooms, and there are some even in government offices in Ottawa, feel that we should be able to reciprocate. It is no secret. Banks, insurance companies and a good many other well run organizations provide this meeting ground where views may be exchanged and so forth. We think it is a rather important aspect of practice.

The Chairman: You are referring to conventions now.

Mr. Rounthwaite: No I am not, sir. I am speaking in terms that I think of banks having those diningrooms, including the Bank of Canada. We also know that various government departments and ministers have such facilities. We find that in the case of life insurance companies and other large corporate clients this is a fact of life. Therefore the Architects' Club is the only equivalent that we can offer in exchange for this form of entertainment. We consider that to some degree we have to be able to pace our clients in these matters. Speaking with respect to the total amounts involved, I asked our comptroller before this meeting if he would venture what sort of numbers we are running into here. He said he thought it might be one per cent of our annual revenue. I believe that most companies would have certainly an advertising budget equal to or greather than that percentage.

Mr. Leithead: Until now we have enjoyed the privilege of deducting the expenses of one national and one international convention each year. We in the Institute encourage our members to attend these conventions, their provincial conventions and our national assembly. This is the common meeting ground for the exchange of information. We feel that this is a development of our members' experience. Certainly our conventions cannot in any way be considered to be frivolous affairs. In fact, there is a good deal of educational content, bringing us up to date on management. For example, there are lectures by the Department of Industry, Trade and Commerce connected with their BEAM program. This has been a feature of several of our conventions. We do have such a very high content of material that unless we receive it we cannot keep pace with the rapidly changing technology and nature of building. This applies to everyone who is in practice, from the youngest to the oldest member.

Mr. Rounthwaite: Referring to conventions, to some degree the Royal Architectural Institute must respond on an international basis. Frequently Canadian architects are asked to go and speak to the American Institute. Mr. Leithead was asked to speak at the International Union meetings. So there is a reciprocity in the form that we might be allowed one or two conventions other than in terms of the national body for tax purposes. Some members will be asked to go to other countries. This should be considered in the nature of an external affairs role to some extent. These are important because it is the dissemination of information in the profession. Many of these programs are instituted by government departments. Central Mortgage and Housing Corporation conduct seminars on housing.

The Chairman: Is it not your experience that very often a branch, department or a number of branches use the occasion of a conference as a sounding board to put forward plans or ideas, or to sell something?

Mr. Leithead: Further to Mr. Rounthwaite's comments with respect to the International Association, we feel our responsibility is to the architects in under-developed countries. We were encouraged by the Secretary of State for External Affairs when we joined the Federation of Pan American Associations of Architects. We belong to the Commonwealth Association of Architects and the International Union of Architects. Being in one of the more fortunately developed countries, we feel that it is our responsibility as professionals to pass as much of this information across as we can for the good of the profession and society. In order to achieve this we must be able to attend, speak and deliver ourselves to these associations.

Senator Connolly (Ottawa West): It is the passing of technology and education, of course. The remainder of this item of the White Paper seems to reflect concern that there is too much so-called "expense account living" which includes meals, clubs and other things which are a part of modern day living and methods of doing business. Perhaps the gentlemen would like to say something about the element of abuse that they find.

Mr. Rounthwaite: Everyone in this room will recall that a few years ago limits were placed on the type of car that could be used for business. It could not cost more than $5,000, et cetera. I gather that after this witch hunt it was discovered that the additional revenues which would be derived by investigating the firms that infringed were less than the amount of tax involved. In most partnerships partners watch each other fairly carefully. If there is a tendency to monitoring, it really comes from within the office. I cannot see how any sensible group of partners will allow one of their number to buy a Rolls Royce, a yacht or a trip to Japan, which is of no benefit to the firm. On that basis I consider this to be exaggerated and do not think it happens very often.

Senator Molson: Some abuse could take place by each person taking his turn.

Mr. J. P. Nelligan, Solicitor to The Royal Architectural Institute of Canada: Mr. Chairman, in answer to Senator Connolly, we feel there is a perfectly valid section in the act now that covers the whole situation. Section 12(1) says:

> In computing income, no deduction shall be made in respect of an outlay or expense except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income.

We feel that is a perfectly valid concept, and the architects are quite prepared to live by it. But surely they should be able to have some reasonable approach to what is necessary to gain their income.

Senator Laird: That is being enforced by the Department of National Revenue.

Mr. Nelligan: That is right, and the fact that there have been abuses does not mean the section itself is improper.

Senator Laird: Exactly.

Senator Connolly (Ottawa West): The fear with which this is watched by the department now has grown to the point where there is a great deal of expertise on it and they are able to assess what a firm's reasonable expenditures should be.

The Chairman: Well, they have seen so many that they are able to make comparisons.

Senator Connolly (Ottawa West): That is right, they now know.

Senator Molson: Perhaps I might comment on the abuse that seems to be suggested in respect of conventions. It really calls into question the value of all conventions, which include the Commonwealth Parliamentary Association and the World Bank meetings. Those are all conventions, and I do not know why in the White Paper they single out conventions. I think there is a tremendous amount of abuse in expense account living, but I do not think conventions should be at the head of the list; I think they should be way down.

Mr. Rounthwaite: Our colleagues in the Public Service are allowed convention money to attend professional meetings.

The Chairman: Where would they get their education if they did not hold conventions.

Senator Laird: There is another aspect of this. We spend millions of dollars through the Canadian Government Tourist Bureau to attract people to this country to use the very facilities which it is now proposed to tax out of existence if we do away with the deductibility of convention expenses. I would like to know how much we do spend through that Government Tourist Bureau trying to attract people here, while on the other hand in effect trying to tax out of existence the very facilities that are being used by these tourists.

The Chairman: What strikes me is there are great international conventions, and one is able to persuade these organizations to hold conventions in, say, Toronto or Montreal in a particular year, so coincidental with or as a necessary adjunct to that there is a tremendous influx of people. If this law comes into effect in the form proposed, the only people who would be attending those conventions and living on tax deductible dollars would be the visitors from outside Canada.

Senator Laird: Precisely.

The Chairman: Everybody else would have to go at their own expense.

Senator Laird: That is right. This brief says it would practically eliminate, or certainly curtail, conventions, and I suggest this is true of every profession.

Mr. Leithead: Also, we have just persuaded the American Institute of Architects to have their meeting in Montreal in 1976.

The Chairman: Well, you have time to change that now!

Mr. Leithead: Hopefully we will not have to.

The Chairman: What is the next item?

Mr. Leithead: We have put in the part about the corporate tax because we have two associations now which permit their members to incorporate, but in listening to all the discussions today I am sure that you do not wish us to add to that, because I think we would only be reiterating what has already been said.

Senator Hays: May I ask a question on that point? Are most of these small firms incorporated?

Mr. Leithead: No, very few firms are incorporated. The two provinces I am referring to are Nova Scotia and Saskatchewan. This is an item that is being debated right across the country, as to the value of incorporation, and it is not necessarily subscribed to by all the practitioners as being the way to conduct a practice.

Senator Hays: So you do not receive the benefits of the small businessman?

Mr. Leithead: Not through our normal form of partnership, no. We are taxed on personal income.

Senator Hays: But you could incorporate?

Mr. Leithead: In those two provinces.

The Chairman: In those two provinces they could because the law permits them to?

Mr. Leithead Yes.

The Chairman: There are two things here that relate more to your operations. For instance, you talk about the Royal Architectural Institute and the component provincial associations being classified with those non-profit associations or societies which will remain exempt from tax on investment income, and you say that the income from fellowships, scholarships, bursaries and research grants should be exempt from tax. What comment have you to make on those? The White Paper proposes that these revenues be subject to tax.

Mr. Leithead: I would like Mr. Nelligan to deal with this.

Mr. Nelligan: The problem here is, I think quite frankly, that in the White Paper they must have made a typographical error, because they seem to exempt boards of trade, labour unions and agricultural associations, but then they lump professional associations in with private clubs and others, which is obviously inequitable, or unnecessary, because if the portfolio of reserve funds which a professional association has is taxed, it certainly means the professionals themselves must pay higher dues, and of course those dues themselves are deductible. I cannot conceive why they would tax these funds when it is in the process of being an undeductible organization.

We can see that if you have a private club, a dancing club, that invests its funds, and by that revenue people can obtain personal benefit without paying dues, there may be some virtue in taxing that portfolio. But surely a professional organization should be in the same position at least as a labour union, and their funds should not be taxed, because all of these are for a business purpose and not for a personal purpose.

Senator Connolly (Ottawa West): Or an educational purpose.

Mr. Nelligan: That is true. This is another problem. First of all, if our portfolio is taxed the dues of every architect in the country will be raised, and this in turn will mean a number of increased deductions across the board. Probably the Government will make a little more money because they propose to tax at the full 50 per cent rate, whereas the architects would then be forced to pay added due and would be taxed at the lower rate because they would not be in that bracket. It is to be remembered, of course, that most architects do not make income warranting a 50 per cent rate; they are much lower than that.

We therefore feel that there is no purpose or point in taxing professional associations. It can be done in one of two ways. They can either specifically exempt it here, or they can put a section in the act under section 62 specifically mentioning professional associations so that they are dissociated from the normal social clubs, as they have already done with labour unions. We feel that fair is fair. If a labour union is exempt, obviously professional associations should be in the same class.

The other problem concerns fellowships and bursaries awarded to promising students who are prepared to undertake further architectural studies. If those bursaries are taxed as income, the architects feel they will have to go out of that business, because they just could not give a bursary of a kind that would be enough to warrant these people sacrificing a year's income in the profession to go and live in another university and study for a further year. We feel that in the interest of technology generally these young men and women should be permitted to take this money tax-free. I think the highest amount we would grant is $3,500 a year and no one can suggest that any professional person would assume that this is a salary and then take a year taking post-graduate studies. We feel that it is in the country's interest to encourage these young people to take these additional studies because this comes down to our mutual advantage. If they are taxed they may not be able to afford this year away from regular work.

Senator Connolly (Ottawa West): What you are saying is that the money received by beneficiary of the scholarship should not be taxed. Is the money taxed that is received and invested by the professional institute and which is devoted to this purpose?

Mr. Nelligan: Under this proposal it is taxed.

The Chairman: It is not taxed now.

Mr. Nelligan: Frankly, there is a device whereby we can avoid that because we have a foundation which is a charitable one at the present time? We would simply put the money in there and transfer that part of our portfolio to the foundation.

Mr. Rounthwaite: While we are on this subject of education there are several other

points which are important. The Canadian professional, in our line of endeavours, must continue to update the capability of his office staff. Many of us send them to take post-graduate work on full salary and pay the tuition. We are no worse than the Bell Telephone Company and other people who do these things. The reason we do it is because significant technical changes are occurring in Britain, Europe and the United States. The only way we can bring this technocracy back is the way the medical profession does. They send the student out to see the operation performed and then bring him back. If we say that we are going to go back or remain in the horse and buggy stage and let the white majesty and power of the great American Institute of Architects overwhelm us we will be in a very precarious position in five years. They have very fantastic updating developments, resource centres and computer centres. The sort of money that they have we could never, as 3,000 people, match their 30-odd thousand. The only way we can avail ourselves of what the British and the Americans are doing is to end our bright young people to get this education. We feel that this has a national significance.

The Chairman: Are there any other points that you wish to discuss.

Mr. Leithead: There is just one more, sir. Our last point is that we would hope that the government will turn to us when they are producing new proposals so we can advise them on peculiarities of our association.

The Chairman: By explanation, the Minister in a speech somewhere recently said something like this: of course, the idea of bringing the White Paper forward in this form was to get the benefit of submissions of all the people who would be affected by it, because they were not able, in the course of preparation of the White Paper and because of their desire to maintain secrecy to go to the sources in order to get the information. That is the explanation that was given. Whether it is just an explanation or meaningful I do not know, but certainly anything that is said here is going to be part of the published material and will certainly be considered in any report we will make and we will certainly be making a report.

Mr. Leithead: I can only conclude then that we hope our brief has been an advantage to your committee.

The Chairman: It certainly has been of value to me I can say personally, both as Chairman of this committee and also as being one of the ones who would be caught on this accrual method.

The committee adjourned.

APPENDIX "A"

Submission Regarding
The Government of Canada White Paper

entitled

"PROPOSALS FOR TAX REFORM"

by

Imperial Oil Limited

March 1970

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INTRODUCTION AND SUMMARY

Imperial Oil Limited is a fully integrated petroleum company whose operations extend from basic exploration through to the marketing of finished petroleum products. Its activities embrace a variety of associated interests, including the manufacture and sale of chemicals and building products, exploration for mineral resources and the sale of products in the automotive after-market.

Over more than ninety years of corporate history, our operations have involved us intimately and extensively with almost every phase of the economy in all regions of Canada. Because of this widespread interest, we do not consider the proposals for tax reform merely from the point of view of a tax-paying corporation directly affected by the White Paper proposals, but also from the standpoint of their broad implications for the Canadian economy and for Canadians. Our submissions are not advanced from any narrow, sectoral interest because, in our view, the future well-being of thousands of customers, shareholders and employees of Imperial Oil Limited would not be served by such a circumscribed approach.

We believe that the government has established a valuable and important precedent in publishing a White Paper as a basis for public debate on proposals for tax reform. Tax reform requires, as a first step, clear definition of objectives appropriate to current and foreseeable social and economic conditions. Implementation of these objectives can only be carried out gradually over a period of time to avoid the highly adverse consequences which could occur from the sudden enactment of sweeping changes in the established tax system. The actual effect of tax reforms on income distribution, forward investment decisions, risk-taking, and competitive position can seldom be forecast with any precision because the uncertainties are too large and too numerous. These very practical considerations demand, therefore, that not too much be altered in any single step or at one time as chaotic conditions could occur.

We submit that tax reform objectives which are appropriate for Canada at this time should be:—

1. To encourage sustained economic growth, without which desirable social objectives cannot be achieved.

2. To stimulate productivity and entrepreneurial risk-taking and innovation.

3. To encourage savings and to attract capital in a capital-short world.

4. To permit harmonization and avoid conflict between provincial and federal fiscal policies.

5. To protect and, where possible, improve Canada's trading position, particularly vis-à-vis the United States.

6. To attract and retain skilled people.

These objectives are not in apparent conflict with those stated in the White Paper. As mentioned in our brief, however, we find that the White Paper's proposals are, in many areas, incompatible with its "stated" objectives. This does not mean that we oppose the aims of certain of the proposals which this brief criticizes. In some cases, we have serious reservations about their feasibility. In others, we seriously doubt that their real effects will be what the White Paper visualizes. It is worth underlining, too, that equity, which the White Paper gives pride of place among its objectives, is not a simple or definable concept. It is hardly a safe assumption that more equity simply means more equality or that there is any easy guide to achieving equity between two individuals whose circumstances differ.

It is always a question as to who draws the guidelines to achieve "equity". Is it necessary to sacrifice growth for welfare, or vice versa? Opinions will differ and one set of rules for "equity" may not be in the long-term interests of the supposed benediciary.

We endorse a number of the proposals aimed at creating increased tax relief for those in the lower income levels. Included in this category would be the higher personal exemptions and the proposed deductions for child care and employment expenses. Also, we would support a tax on realized capital gains provided the rate did not exceed 25 per cent and that it exluded owner-occupied housing, personal property and any quinquennial revaluation of widely-held corporate equities.

We are also glad to note that tax relief is proposed for business expenses now commonly referred to as "nohtings" and that the present system of capital cost allowance would be retained. However, we are concerned, in light of rising capital intensity, by the comment that existing rates appear somewhat high and may be re-examined at a later date.

We suggest that Canadians must seriously question proposals which would diminish

growth prospects for the Canadian economy; provide personal taxes substantially higher than those of the United States for an important segment of our population; introduce a complicated distinction between public and private companies and tax their shareholders differently; and finally those which would substantially increase the amount of record keeping and the cost of tax administration for the government and for taxpayers.

As an alternative to these adverse aspects of the White Paper, we recommend that tax reform should embody:—

1. A personal rate structure which would not significantly exceed U.S. rates.

2. The present dividend tax credit system in lieu of the proposed integration concept.

3. The present two-tier corporate income tax for small businesses.

4. A depletion allowance for the petroleum industry which would be calculated as a percentage of gross income from production at a rate at least competitive with the current United States rate, and including an appropriate limitation based on net income from production.

Canada has a good opportunity to supply, on a competitive and economic basis, extensive and growing export markets. The significance of both crude oil and natural gas in the national economy has intensified the importance of a depletion allowance as a means of maintaining adequate secure supplies. At the present moment, the oil industry is exploring in the more remote, high-cost areas and an adequate depletion allowance tends to offset the bias against risk-taking in the capital markets. Thus, it is Imperial's judgment that the oil industry should be provided with an incentive which is at least equal to that provided in the United States, where our largest export market exists.

The proposal under the White Paper places a limitation whereby the existing allowance of one-third of net producing profits could not be exceeded and, in addition, the restriction of one dollar of depletion for each three dollars of eligible exploration and development expenditures is a severe case of effective retroactive taxation. It is granted that a transition period of five years is suggested to partially overcome this effect. The result still remains, however, that the tax on income from prior investments would, after 1975, be increased by 50 per cent, even though, in many cases, they had been acquired at costs which properly anticipated present tax depletion provisions.

The White Paper proposal penalizes everyone who spends less than 150 per cent of their net profit on exploration and development. It is Imperial's considered opinion that this penalty point is much too high.

Apart from the serious retroactive effects, it should be clear that the effect of changed depletion provisions is not merely to alter profitability levels of crude oil production; rather, it is to change attitudes to risk-taking, to alter the scale of the exploration effort, and, where relevant, to alter the payments which explorers can afford to make to holders of mineral rights, e.g., to the Crown.

Even if the depletion credit formula of the White Paper provided one dollar for each two dollars of eligible exploration and development expenses, the retroactive tax burden would remain and Canadian producers would be at a disadvantage versus U.S. companies in their Canadian operations. Without a gross depletion formula equivalent to that available to their U.S. competitors, Canadian producers need at least the protection of a ten-year transition period and should have the cost of acquisition of Crown mineral rights and all classes of development expenditures included as eligible expenditures in the calculation of depletion.

This summary statement covers only the highlights of our reactions to the White Paper proposals. The attached submission states our position in substantially greater detail and includes comment on a number of matters which, in the interest of brevity, could not be included in a summary statement. In addition, where it illustrates that proposals appear to be inappropriate, unworkable or in conflict with the White Paper's stated objectives, it offers alternative proposals.

IMPACT

Contrasts Between Objectives and Actual Proposals

Basic affirmations are to be found in the White Paper to the effect that:—

(i) A "..... main objective of tax reform is to see that the tax system does not interfere seriously with economic growth and productivity." (1.10).

(ii) "... our corporation income taxes are already high by international standards; further increases would be damaging

to our economic development and competitive ability, making it more attractive to locate industries in other countries." (1.20).

(iii) "... reforms should not include retroactive changes, applying to incomes earned in previous years." (1.12).

(iv) The government believes that the Royal Commission on Taxation ".... carried some of its arguments to extremes which the Canadian public would not support." (1.8).

(v) Capital cost allowances have "... acted as an incentive to taxpayers to modernize and improve their business facilities, ..." (5.14).

(vi) "For the foreseeable future Canada's capital requirements will continue to exceed available domestic savings." (6.8).

(vii) In relationship to the mining and petroleum industry, important regional considerations are noted in that "... inducements are intended to encourage the establishment and growth of highly productive industry in areas of Canada outside those where rapid urban and industrial growth are already occurring." (1.50).

With all of these basic affirmations, we find ourselves in agreement. Indeed, in the course of Imperial Oil's submission to the government concerning the Report of the Royal Commission on Taxation we expressed the view that the appropriate policy goals should be:—

1. Stimulate increased productivity in order to maintain and encourage international competitiveness.

2. Maintain a viable international payment situation, compatible with the capital needs of the country and international monetary agreements.

3. Encourage capital generation from both internal and external sources.

4. Not impose levels of taxation in excess of those prevailing in the United States.

5. Encourage the retention and development of the maximum stock of human skills.

6. Not impinge on regional development.

In analyzing the White Paper recommendations, we are deeply concerned to find that they clash with their own stated principles. We are left with the impression after considering the Royal Commission Report and the White Paper that a specialized government task force to elaborate tax changes will be impelled to do just that—seek to catalogue a long list of prescribed tax modifications, the more the merrier, even at the risk of sacrificing basic principles which the proponents themselves profess to espouse. By way of contrast, a government agency charged with protecting and encouraging the economy, maintaining a competitive position with others, improving our international balance of payments position and stimulating regional development would probably be inclined to introduce measures of a tax nature, amongst others, quite different than those set forth in the White Paper, all the while formulating allegiance to somewhat similar economic principles. A government medium charged with encouragement of the arts will react to a capital gains tax on the sale of art objects in a manner quite alien in thinking to the White Paper formulators and vice versa. It is only in contemplating the effects of conveying a mandate to any concentrated group that we can explain how the authors of the White Paper can arrive at conclusions which seem to be at such variance with their own basic guidelines. It is indeed fortunate that the Canadian government has announced its readiness to welcome criticism and it is this spirit that we find ourselves duty bound to express such criticism.

In effect, more emphasis is placed in the White Paper upon departure from its objectives than adherence thereto. Economic growth and productivity are espoused in negative terms. The tax system must not interfere "seriously" with it. It emerges almost as a secondary objective subservient to supposed fairness and equity. Surely it is not a matter of selecting one or the other. What is more unfair and inequitable to all Canadians than any measures which might contribute to unemployment, arrested growth in production, deterioration in our economic development, our standard of living and our relative position vis-à-vis other industrial countries? Our tax system must permit production of wealth rather than enforce distribution of poverty.

By its own reckoning, the adequacy of which we shall presently discuss, the White Paper estimates that when fully operative in the fifth year its aggregate tax changes would bring about an overall reduction of $525 mil-

lion per annum in savings—based on 1969 income levels and dollar values (computerized on actual 1967 figures). This was not a buoyant year, a year of "full employment" or even of unemployment within the tolerable limits outlined in the Carter Report. However, it is suggested that this figure should be compared with personal and corporate savings and capital cost allowances of about $14.0 billion in 1969. There is an obvious implication that by comparison with such an impressive total, a mere diminution of $525 million in any one year with its resultant loss of employment opportunities and productivity should not concern us unduly.

A Decline in Savings as Viewed by the Government's Economic Advisers

Such a readiness to accept a decline in savings may be contrasted with the warnings embodied in the most recent report of the Economic Council of Canada—Perspective 1975"—to the effect that:

1. "To achieve potential output in 1975—that is, an expansion of over 50 per cent in the volume of total output from 1967 to 1975—will require substantially increased investment in business plant and equipment, inventories, housing and social capital. To finance this substantial growth in investment, the economy will therefore also need to generate a very high rate of growth of savings." (page 93.)

2. "Looking over the period to 1975, the strong demands for saving required to finance Canada's capital investment needs at full potential will be developing in a situation of a continuing world shortage of capital. Not only is the demand for savings high in the industrially advanced countries, in which high rates of economic growth are generally associated with high rates of growth of new investment, but the underdeveloped countries also have very heavy requirements for development capital and are seeking to meet a significant portion of such needs through capital inflows from abroad. Canada must therefore continue to have a high-savings economy." (page 103).

3. "We wish to emphasize that the achievement of Canada's potentials which we have set out in these chapters could be jeopardized by serious financial instabilities; they can only be accomplished if financial markets at home and abroad are working reasonably smoothly and efficiently." (page 105.)

4. "... a very rapid growth in total savings will need to be achieved over the period 1967-75." (page 95.)

In the face of such warnings, any degree of decline in savings cannot be viewed as insignificant.

Gains in Revenue Versus Loss in Economic Incentive

If the contraction is to be weighted in the perspective of aggregate savings, the same type of measurement may be applied to government revenue increments against the background of aggregate tax revenues. Apart from personal income tax rate change results, the greatest single source of increased government revenue derives from the elimination of the lower rate on the two-tier system introduced to encourage small corporate enterprise in 1949 and applied and extended ever since for such purpose by successive Canadian governments. It is estimated that this particular modification will produce $95 million of extra revenue the first year and $390 million by the fifth year. Quite apart from the merits, this quantitatively most important items is not directed towards encouraging productive enterprise, whilst the burdens of the change will fall relatively more on the middle rather than the higher income brackets.

The anticipated yield of capital gains taxes (individuals and corporate combined), calculation of which is perforce based on some very broad assumptions about unknown future stock market trends which in turn will be affected by unmeasured productivity trends, is $95 million of revenue in the first year and $345 million of extra revenue by the fifth year plus an additional $100 million on quinquennial unrealized gains. The very sweeping changes in the corporate integration system are expected to provide reductions of $140 million initially and $230 million by the fifth year. If each of these types of tax revenue changes are to be compared with the total tax take by all Canadian federal, provincial and municipal governments of $27.6 billion for 1969 whereof some $11 billion is allocable to personal and corporate income taxes, the question may well be raised as to the fundamental wisdom of embarking on dislocating measures productive of such uncertainty and of such discouragement to enterprise out of all pro-

portion to the relative increment in government tax revenues envisaged as a consequence thereof. If a decline of savings of $525 million is viewed as relatively modest against the aggregate volume of savings, how much more so do the tax take consequences for the treasury appear insignificant to justify the resultant cut in savings.

In any event, we endorse the view of the Economic Council of Canada that any proposals which would slow up economic development cannot be viewed with equanimity and, on the contrary, bode ill for Canada.

The Drop in Savings

Nor does the measurement of the loss appear to be suitably evaluated by the $525 million per annum acknowledged. The estimate itself has been seriously challenged by other government agencies. On its own premise of a 1969 base, substantial upward adjustments for subsequent years would normally be required. The estimate makes no provision for the reduction in savings available to the extractive industries where the main impingement arises after the initial five-year period. Nor is any attempt made to gauge the cumulative effects of a continuing decline. The banking system and capital markets by themselves serve to multiply the effects of any drop in savings by a far more than proportionate decline in credit, just as the converse would be true in the opposite direction. No account is taken of any adverse entrepreneurial reaction to the spirit and scope of the recommendations. Apart from the psychological considerations, economic rigidities would accentuate the retardation of new enterprise and further aggravate regional disparities.

Loss of Attraction of Foreign Capital

Quite apart from the predicted decline in domestic savings, the White Paper makes no attempt to evaluate the prospective thinning of the flow of foreign funds to Canada as a result of its recommendations. At a very time when there is a worldwide shortage of capital, when the slowing down of capital investment has brought about a visible retardation of growth of the Canadian economy, measures are proposed which will divert foreign capital elsewhere. Amongst advanced industrial nations, no economy is more interdependent upon the international movement of goods, capital and securities, than that of Canada.

To understand the international pattern, it is helpful to examine the interregional equivalent. It is not suggested that the interregional and international patterns are identical, but the differences are those of degree rather than of substance especially in assessing relations with the American economy. Suppose the different provinces of Canada were literally to adopt the equivalent recommendations of the White Paper within their respective intraprovincial spheres. Imagine for example higher rates of capital gains tax imposable provincially on investments outside of the borders of a particular province by comparison with those in the province. Let us for a shuddering moment contemplate integration benefits available to residents of a province in respect solely of shares of companies incorporated or operating therein. Imagine that Ontario, Quebec or British Columbia might deny the right to opt for partnership treatment in the taxation of closely-held corporations where some of the shareholders were residents of another province.

What would happen if one of the provinces suggested that by moving to another province a taxpayer should be deemed to have realized a gain on the enhanced value of all of his world assets for provincial capital gains tax purposes, and then let him fend for himself in seeking to obtain a credit under the tax system of the province to which he has moved? Such shattering concepts are admittedly extreme but, at least by way of caricature, they underline some of the problems in the international flow of capital which the White Paper recommendations would initiate or aggravate. Again these consequences must be weighed against the objectives of achieving something fair and equitable for the Canadian people and of maximizing growth and productivity or, at least, not discouraging it.

Measures affecting non-resdents all point to substantial tax increases with consequent disincentives to investment. A capital gains tax is proposed at rates higher than those prevailing in other countries with the consequence that, even if the credit were available, it would not suffice to offset the discouraging impact. A tax on unrealized gains is so eccentric, by international as well as by domestic standards, that no credit is foreseeable for non-residents on this score under their own tax systems. It is not possible to measure the extent of the resultant loss but it is equally impossible to ignore the sharpness of the doward trend that would result.

A slowdown in the generation of capital, from domestic and foreign sources, however it may be measured, is a doubly harsh blow to the Canadian economy. It comes at a time when needed increments of capital are so difficult and expensive of attainment. It is no answer to compare by implication or otherwise an added burden to an existig one. No matter how much one sings to the camel of the weight of his existing load there still comes a point when an extra straw will break his back.

Fiscal Policy—Timing

In choosing to maintain a discreet silence about fiscal policy, the White Paper is impervious to the inflationary or deflationary consequences of any particular policies. In the result and without any reference to the appropriateness or otherwise of the time of adoption, proposals are advanced which, under current circumstances, can only aggravate the present inflationary spiral. Individual and corporate capital accumulation and savings are discouraged whilst immediate consumption and expenditures are encouraged irrespective of the policy needs of the moment.

The longer range outlook is even worse. The most salutary cure for inflation is to be found in augmented production which balances the gap between supply and demand on a basis most consonant with a constantly rising standard of living. Not only is the erosion of the purchasing power of the currency arrested but also this goal is achieved with rising employment and fuller utilization of available resources. The recommendations of the White Paper point in the opposite direction. Apart from the immediately inflationary pressures created by unleashing new demands without corresponding output, incentives and encouragement are replaced or reduced and new disincentives are created. Every new business that is aborted or stillborn, every small corporation that fails to generate and retain enough capital for survival and expansion, every individual or corporation discouraged in the drive to maximize output would represent a government-created wastage of opportunities, contraction in the gross national product which might otherwise be attained, and a further accentuation of trends which combine on the one hand continuous inflation and on the other hand persistent unemployment. Many important tax changes have to be suitably timed and and not indiscriminately initiated solely on the basis of when we can end the debate and finalize the drafting.

Immutability of the Maximum
Permissible Rate

Even the supposed achievement of fairness and equity and abstention from undue discouragement of investment as embodied in the White Paper are delicately balanced on the basis of immutable fixation of certain maximum rates, both corporate and individual at a level not exceeding fifty per cent. In the language of the White Paper:—

> "A higher rate, when applied to a comprehensive definition of income including capital gains, would deter savings and the investment of savings, particularly in venturesome enterprises. Moreover, there is a danger that rates higher than 50 per cent applied to the earned income of professional workers and executives would lead to some slackening in their efforts and a desire to take benefits in the form of holidays, retirement pay and other non-productive and less-taxable forms. Canada needs the full effort of those with outstanding ability. It must compete for such people with other countries where able Canadians can go to live and to work if they wish.
>
> "Nor should top rates of personal income tax be significantly above rates of corporation income tax. A substantial difference provides an incentive for wealthy people controlling corporations to accumulate income in the corporation rather than pay it out as dividends. Means may be found of converting these surpluses into forms that will benefit the owners without attracting personal tax at excessive rates." (2.39—2.40)

While the maximum in tolerable rates on which everything else hinges is clearly defined, the White Paper ignores all factors of upward and downward movement of rates in accordance with prevailing or immediately anticipated economic considerations. By implication we might be able to edge rates upward if our American neighbours do and we must correspondingly move in a downward direction whenever they do. Any independent Canadian fiscal policy would be eliminated or at least subordinated. As the economic and fairness and equity postulates of the White Paper depend upon a tolerability level at a maximum 50 per cent rate, it ought

to follow that the immediately projected tax structure should be constructed currently at quite a few points below the tolerable maximum. To build at the breaking level point is never a recommended or even permissible practice. Indeed, in the present projection, the White Paper acknowledges that the starting point rates are substantially higher than 50 per cent and contemplates a downward adjustment (although never quite to the 50 per cent point) as the full bite of the capital gains tax cuts all the way.

Furthermore, it is contemplated that "The top federal rate after the transitional period would be 40 per cent,......" (2.44). Not only is there an absence of any upward leeway for the provinces, but some of them would be called upon to accept a substantial lowering of current rates, individual and corporate, to keep within the permissible top limit. Thus we are told in the White Paper that its major proposals depend, for their fairness and equity, and absence of any substantial discouragement to enterprise, upon maximum levels of tax rates which do not exist, are not really projected and cannot be assured. By the standards set forth in the White Paper, therefore, these major proposals will be unfair and inequitable and will unduly deter economic activity. It makes it even worse to contemplate that these consequences will ensue to a greater extent in some provinces than in others.

What is fair and equitable at one rate of taxation for the newly suggested imposts, especially in the capital gains field would, under the White Paper approach itself, become unfair and inequitable at a higher rate and it is this higher rate which will be feared and expected. What is acceptable economic policy predicated on a fixation of rates at an absolute maximum level ceases to be so if there is no way to anchor the rates at such point.

How could there be? There is an immediate credibility gap, the disastrous consequences of which are foreshadowed in the foregoing excerpt from the White Paper. Ministers of Finance and future sessions of Parliament must be free, notwithstanding the strictures of the White Paper and the delicate balance on which their whole structure is developed, to modify rates upward and downward. Provincial Ministers of Finance are no more likely to kneel at the altar in unswerving devotion to these principles. As the White Paper so aptly expressed it: "Individuals and businesses must be able to plan their affairs sensibly, particularly in making investments that yield a return for many years." (1.12). The public cannot be induced to expect any maintenance of stability of maximum rates at levels beyond which enterprise is discouraged. The disheartening consequences that are foreseen in the White Paper itself if the rates get beyond these maxima will ensue from the very outset because of lack of confidence that these fundamental limits will be long preserved or even momentarily attained. The very dangers underlined by the White Paper itself will be upon us because few, if any, will have confidence or could have any confidence that the delicate balance applied in the maximumization of rates can be permanently assured. This absence of confidence makes the climate for investment one which the White Paper indicates must be avoided!

Fiscal Policy—Stock Market Fluctuations

The new system appears to be slanted in the direction of inducing Ministers of Finance to do the very opposite of that which would be required to achieve economic growth or at least some stage of equilibrium. Nothing is more unpredictable than the five-year course of the stock market, even for those who write White Papers. A prolonged downward slide in the market reflecting deterioration in the economy would, under the proposed system, deeply accentuate the decline in government revenues. Stock market losses would be deductible from taxable income. Government tax revenues from the well-to-do would go tobogganing downhill with the stock market. It is precisely during such an adverse period that heavy tax cuts for the other income groups ought to be recommended in order to stimulate the economy. Conversely during a boom period, when government revenues are most buoyant taxes ought to be increased, even presumably beyond the fair and equitable limits otherwise applicable. The new system would severely strain the Ministry of Finance which will be called upon by accepted fiscal policy considerations to slash such revenues by cuts in one direction at the very time when they have already been sharply curtailed in another. No tax system in the world would be as dependent upon stock market vicissitudes as the Canadian one. To introduce the vagaries of the stock market with its long term ups and downs in the proposed manner is to impair, if not to render completely unworkable, sound fiscal planning.

Taxation—More or Less

Eschewing considerations of fiscal policy, the authors of the White Paper were faced with another dilemma. On the one hand, it was intended to construct a theoretical tax system productive essentially of the same yield as exists at the present time. On the other hand, throughout the transitional years there are shifting yields and developing changes. There is no serious evaluation of what is an appropriate transitional period having regard to such drastic changes in the corporate and personal income tax structure, but an arbitrary five-year term is selected. If the appropriate tax system which the White Paper judges to be fair and equitable, based upon current yields, current dollars and current production can be only attained after a five-year development, the logic of the effort of the White Paper to stand aside from modifying aggregate tax yields would have dictated a tax system which in five years would bring what the tax system brings today, with suitable adjustments for any increase in productivity or national income and any decline in the purchasing power of the dollar—or vice versa as the case may be.

To do that would have resulted, because of the transitional factor, in a tax yield at the present time lower, after initial implementation of the White Paper proposals, than today's level. As a practical matter and even at the risk of sacrificing the basic guidelines of this approach, this had to be avoided at all costs lest it appear immediately unpalatable to the Minister of Finance. Accordingly, the selection was made of proposals which would produce"... approximately the same revenue in the first year of their operation as would the existing income tax system." (8.1). The consequence of this choice is to produce, in current dollars and at current G.N.P., the equivalent of some $630 million of extra taxes in the fifth year. Again this bias in favour of increased taxation is adopted without the slightest reference to fiscal imperatives and the economic consequences implicit therein.

"In Extremis"

When we measure our position in relationship to our dynamic neighbours to the south and when we evaluate incentives or disincentives to productivity, we must not only examine the ultimate intended resting point of any measure but also the respective points of departure. A theoretical system cannot be viewed in a vacuum. For the taxpayer at work or in business, the rate of change, the withdrawal of an existing incentive or imposition of a new disincentive, the immediate contrast with his previous position and the availability of alternatives will all influence his reactions and quicken or arrest new or expanded enterprise.

Never in the history of taxation in the civilized or uncivilized world has any government—except for those who have imposed outright confiscation—introduced such a drastic measure of tax changes as would be embodied in implementing some of the proposals of the White Paper. Tax on capital gains would move overnight from zero to levels which could attain 81.92 per cent and even more in many provinces. For those who had purchased assets at prices above the quotations applicable on valuation date these taxes at such rates could apply even though heavy losses were ultimately sustained at the moment of realization when measured against actual costs. Whilst future tax rates are normally a great budget secret, in this case, taxpayers will be told that a deferment in realizing any capital gains will bring the ultimate level of taxation over a five-year period sharply downward. Anticipatory sell-outs before adoption of the new law are encouraged whilst transactions in the ensuing five-year period will be partially paralyzed.

Foreign corporations who were induced by a previous incumbent of the post of Minister of Finance to offer some of their Canadian subsidiaries' shares to the public face the prospect of being very seriously disadvantaged by the proposed measure on deemed realization of their holdings every five years. A long catalogue of such crushing consequences could be compiled.

When the authors of the White Paper reflected upon the recommendations of the Royal Commission, which inspired their own conclusions, they found many of them to be "extreme". They should not be surprised to find a similar reaction to their own proposals. For the reasons set out in the present submission such a reaction is well-founded. It might be noted, in passing, that even if it were not so well-founded it would be productive of very adverse consequences for the economy of our country because decisions to embark upon or expand enterprises are based upon the understanding, and even should it be the case the misunderstanding, of anticipated tax consequences on the part of risk-takers and decision-makers. We have been informed that the White Paper has already retarded the pace of generation of capital and its

implementation can only aggravate this retardation.

There is a revulsion against patching up the tax system but this is not overcome by a multiplicity of bigger patches as proposed in the White Paper.

Strains on Tax Administration

The White Paper is also tactfully silent about tax administration. Even under the most ideal of circumstances the introduction of such extreme modifications, by comparison with a stage-by-stage evolution in our tax system would impose enormous strains upon those charged with responsibility for tax administration. Such a burden would only appear to be justified when there is a clear and present advantage to occasion it. The onus of proof must, therefore, devolve upon the originators of the White Paper. Bereft of accepted and understood guidelines on both sides, judicial interpretations established over a long period of time, detailed experience in the methods of administration, to say nothing of the uncertainty and hazards of complicated drafting challenges, the tax administrator and the taxpayer alike would suddenly be thrust forward into unknown territory full of doubts and pitfalls. This too can only exacerbate the climate for investment and economic growth. At very least an advance ruling system should be assured as an accompaniment of any major revision.

In short we are faced with a series of proposals which, in main essentials, cannot be linked to, or justified by, the criteria established even in the White Paper itself and which stand condemned by these very criteria. It is to the details of some of these proposals that we now turn.

THE CAPITAL GAINS TAX

Although we do not anticipate that Imperial Oil Limited will be materially affected by this tax, we believe it has many undesirable features and is formulated in a manner which is not in Canada's best interests at this time. To the extent that it inhibits the growth of the economy, all Canadians and Canadian corporations will suffer.

Recommendations

For the reasons set out below, we urge that if a general capital gains tax is enacted it should not exceed 25% or be applied to owner-occupied housing and personal property. It should only apply to realized gains and should exclude any quinquennial revaluation of widely-held corporate equities—an administratively horrendous and discriminatory concept.

Timing

The White Paper makes an impressive point in affirming that a realized capital gain enhances a taxpayer's ability to pay and a realized loss detracts from it. By itself this lays the foundation for some taxation of capital gains. Appropriate timing for the inception of such a plan is ignored. Interest rates have reached new unprecedented heights and there are no signs of any serious abatement. Businesses are facing a constant crunch of rising costs impinging upon profitability. These factors weight heavily in the scales when new or expanded undertakings are considered.

For the investor any prospective appreciation in the value of his holdings (other than shares of widely-held Canadian corporations) will be halved by a capital gains tax at 50%. It is quite true that the scope of his after-tax risk will also be reduced but risk-takers approach their investments with greater emphasis on the upward than the downward possibilities, usually expecting their judgment to be vindicated by the constant erosion in the purchasing power of money. If risk-taking and venture capital are scarce enough as it is, they must inevitably dwindle even further after capital enhancement taxes are applied. An investor now at the 80% maximum rate would, under the White Paper, have his maximum rate reduced to a little over 50%. His net return after taxes on high interest yielding securities would be much higher than before. Other investors would find their net returns on such securities relatively unchanged. For all investors, net equity returns would often be sharply reduced. Indeed, the whole thrust of the White Paper is to favour the passive investor, who neither toils nor spins, at the expense of the risk-taker and the economic entrepreneur.

A prolonged decline in the stock market such as that which has been experienced over the last six months places the whole matter of a capital gains tax in a somewhat different perspective. Had the White Paper system been in operation during 1969 it would appear that a considerable proportion of taxpayers in the high income tax brackets could have eliminated all liability for tax by the simple device of liquidating those of their holdings which had declined in value.

Capital Gains versus Income

Whilst the assimilation of capital gain, which may be the product of long-term accumulation, to ordinary income has the great advantage of a simplistic approach, it is completely irreconcilable with a progressive rate of annual taxation unless it is accompanied by very generous averaging provisions of the character proposed in the Royal Commission Report but not duplicated in the White Paper. (See Table 1.) It runs counter to the recognized limits imposed elsewhere. Even in England, with its readiness to accept the less dynamic approach to industrial growth and a high tax proclivity philosophy at least on the part of its government, capital gains taxation was approached far more circumspectly. First the 1962 measure embraced only realized short-term gains. Then in 1965 a general overall capital gains tax was introduced and a special rate fixed at 30 per cent. In passing it may be noted that the U.K. government initially considered the imposition of a deemed to be realization which in form is comparable to that in the White Paper, but they limited it to trust holdings only and proposed a ten-year period of realization. On reconsideration this measure still limited only to trusts, was softened to 15 years.

To evaluate the effect of a capital gains tax and the burdens it would appear to impose, it must be linked to the recent changes in gift taxes and death duties summarized in Table 2. Both of these measures embodied very drastic changes in taxing capital formation and retention. When combined with the proposed capital gains tax they strike a very hard blow at family-controlled enterprises and impel selling out as quickly as possible before the patient dies and preferably before the new law is born.

The desire, no matter what the consequences, to obliterate all distinctions between capital gains and income is responsible for one of the clumsiest proposals in the transitional period. Although the capital gains tax is not estimated to yield very much in the preliminary years, it is applied initially at high rates, way above the limit of what is acknowledged to be fair and equitable. This will cause an obvious deferral of any capital gains realization within the first five-year period except for the hapless circumstances of those who are unable to postpone their intended sale until the rates reach the promised lower levels. Accordingly, the procedure for a gradual reduction in rates is self-defeating for most, extremely harsh for a few. The inequity becomes all the greater as there will be every incentive to sell on a realized loss basis wherever the occasion permits. The alternative of immediate adoption of reasonable rates appears unacceptable to the Minister of Finance for the reasons already mentioned. The only solution is a flat rate for capital gains on a different basis than that of ordinary income. The intolerably vexatious transitional dilemma would thereby be resolved.

If a capital gains tax is to be imposed, a reasonable maximum rate should be set with due regard to competitive conditions elsewhere, the historic difference between what has been previously taxed and what is proposed, the gap between our potential and the far from mature stage of our economic development, the need for enhancing rather than impairing capital formation, the desirability of more small firms expanding and attaining the stage where they may "go public", the averaging principle implicit in capital gains realization, and the differences between long-term and short-term gains. The maximum level should be set at a rate somewhat below 25 per cent.

Retention of the system of capital cost allowances, as proposed in the White Paper, is an acknowledgment of the difference between what is on capital and what is on current account—an acknowledgment that should avail on the revenue as it does on the expenditure side. Difficulties in distinguishing between the two can be substantially circumscribed by assimilating short term capital gains to income and by creating, as has been done in other countries, reasonable time limits which can create either rebuttable or, in the case of other than dealers, irrebuttable presumptions of being on capital account. The troublesome concept of "an adventure in the nature of trade" can then be buried without any mourners.

The Quinquennial Tax

The quinquennial tax to be imposed every five years on unrealized paper profits on investments in widely-held Canadian companies puts a sharper bite on invested capital than any known capital tax. Some of the difficulties have already been publicly noted by the Minister of Finance. In an inflationary era it taxes merely the holding of investments which "grow" in value at the same rate as the currency depreciates. In a time of widely fluctuating security prices, it can tax the "ups" with little relief for the "downs", as illustrated by Table 3.

Its alleged justifications are:—

(a) It avoids deemed realization on death and having capital gains tax and death duties apply "at a most inconvenient time". (3.42).

(b) It would reduce the "lock in" effect and "...what might otherwise be an obstacle to the workings of the capital market." (3.37.)

(c) It would reduce tax postponement.

(d) It would facilitate the classification of "...reorganizations and mergers as tax-free transactions..." (3.37.)

While the justifications above have some validity, the White Paper vastly overrates them as against the sheer inequity of taxing unrealized paper profits which may never be realized and the heavy blow to investment in widely-held Canadian corporations which will ensue:—

(a) Taxpayers would normally prefer payment of a dollar of tax later (at death) than earlier (at quinquennium).

(b) There is no discussion as to how serious the "lock in" effect really is and why it justifies taxing paper profits.

(c) Would the quinquennial tax reduce postponement or more truly increase prepayment? After all the justification for the capital gains tax (3.2) is related to realizations.

(d) While facilitating the handling of reorganizations and mergers is important, is it important enough to justify taxing paper profits?

The White Paper does not come to grips with the fact that taxing unrealized paper profits introduces a hazard of entirely new dimensions into the investment in Canadian equities. This new risk may to some people outweigh the lower tax rate imposed on Canadian equities and drive them out of Canadian stock holdings. To these investors a tax on the full gain if, as and when realized, coupled with a full deduction for capital losses, may be less fearful than a tax at half rates on paper profits which may disappear like the burst of a bubble.

The imposition of the quinquennial tax will surely discourage the purchase of what are hoped to be fast growth Canadian stocks. Over a long period of time and with a high rate of growth, the full capital gains tax on realization is less onerous than the half rate every five years. Added to this, the quinquennial tax reduces the investor's income during the holding period which a tax on actual realizations would not do.

Coupled with the recent sharp increases in gift and estate taxes, the quinquennial tax creates an unattractive environment for Canadian savings and capital. For example, the estate tax rate of 50 per cent is now reached at \$300,000, whereas formerly this level of taxation did not apply until an estate exceeded \$1,550,000. This environment is much worse than in the United States.

The Quinquennial Tax and a Family Enterprise

While Imperial is not directly concerned, it would be well to consider the consequences for a family enterprise. For example, as business expands, a family-controlled company may reach the stage where it can go public. To achieve this objective, the existing management must continue; perhaps 20 per cent or 30 per cent of the total shares outstanding are distributed to the public. If a tax is to be imposed every five years on the rise in the quoted stock market value of such an enterprise, even though the owners have not sold any more of their shares, substantial funds will be required without any corresponding ability to pay. The Canadian market is notoriously "thin". To raise the money to pay the taxes would normally require the sale of blocks of stock. The mere attempt to sell such stock would usually depress the market in the shares of this particular company. In some cases, the first or second stages of deemed realization would necessitate loss of control of the enterprise, or the necessity of seizing the first opportunity to sell out completely.

Selection of the five-year period based upon individual or corporate birth-days ending every five years appears ingenious. It was intended to prevent the impact of dumping vast quantities of stock on the market for all listed companies at the same time. Where shares of a widely-held corporation are diffused amongst many shareholders none of whom holdmore than, say, 1 per cent of the total outstanding stock this method of timing will achieve its purpose. But there are many typical Canadian companies where the originating families still control as much as 50% or so of the stock or, at any rate, very large blocks of it. To them a quinquennial tax must mean facing the prospect and, in many cases, the certainty of loss of control.

During periods of wide variations of stock market values the timing of the quinquennial

tax in relationship to birthdays of controlling shareholders will have all of the assurance, fairness and equity of a lottery or of Russian roulette. A moment's reflection will show what the impact would be during a period of inflation or, leaving that aside, what the consequences would be for any undertaking which has succeeded in enhancing its earning power and consequent goodwill. Suppose that in one or two quinquennial periods a block of $500,000 worth of stock has grown in value to $1 million, without any sales or realizations. No money is received, but the shareholder at the 50% rate or so which would probably be applicable at his bracket under the White Paper would immediately owe a tax of some $125,000.

How does he raise it? The ordinary solution would be to sell the stock, but in the typically thin Canadian market any such operation is likely to have a depressing effect on the price. If in our sample illustration above mentioned, the $500,000 block of stock has grown in the five-year period (or with suitable variations for the earlier taxes a ten or fifteen-year period) to $1 million, as a sort of "birthday present" from the government, the shareholder will be called upon to pay a tax which, by virtue of the amounts involved irrespective of whether he had any income from other sources, will all be taxed at or near the maximum rate of tax which is theoretically 50%, for a total of $125,000. Under the shock of such an assessment he passes away. The heirs will now be called upon to pay estate taxes on an asset valued at $1 million. It is true that the liability for unpaid income taxes is deductible from the value of the estate and that if there were no other assets almost half of the residual estate might be subject to taxes at rates lower than the maximum approximating 50%. If there were some insurance equal to the income tax liability and about $300,000 of other assets accumulated, the million dollars in inherited securities would be subject, at the marginal applicable rates, to an estate tax of about $500,000. In relationship to the shares in question the family would have been called upon to bear a tax of $625,000 between the estate taxes and the quinquennial taxes without a dollar in cash being received. If the attempted liquidation of the stock on the market occasioned a depression in quoted values, as it almost inevitably would, it would not have to go down very far before the total taxes already payable exceeded the entire proceeds. Any loss on realization would avail as a tax credit on income which the estate will not receive or be able to use, and even if the loss carryforward is extended beyond the present rules, in a manner not proposed in the White Paper, the loss on realization may never in practice be deductible. Euthanasia for mortally ill people on the eve of their quinquennial birthdays might become a debatable issue.

It is not by any means suggested that this would be the typical case, although it would occur under many circumstances. But, in any event, it underlines the degree to which family holdings in widely-held companies would be imperilled.

Whatever the reasoning on which it may have been sought, a quinquennial tax is nothing less than a tax on capital applicable exclusively to investments in Canadian widely-held corporations. After World War I, in some devastated countries, there had been an effort to initiate taxes on capital but the experiences were invariably disastrous. It matters not that the deemed realization tax was not intended perhaps as a capital levy which in fact it is. It cannot be defended, either from a theoretical or a practical viewpoint.

Moreover, the entire thrust of the White Paper recommendations is supposedly to favour shares of widely-held Canadian companies. In view of investor experience in, and expectation of, some inflation, the quinquennial tax by itself will deter many of them from investing in Canadian public companies. It will discourage the operators of growing businesses from going public and thereby arrest useful growth and development. To those who venture internationally it provides strong grounds for establishing parent company operations in the United States and moving senior personnel charged with central control and management of the enterprise to an American base where they might otherwise be located in Canada or where they may have been previously situated in this country.

The International Position

The application of the quinquennial tax to non-resident shareholders of 25 per cent blocks of widely-held Canadian companies appears to be a breach of faith to those non-resident companies who were induced to offer their shares on the Canadian market by representations that this would be widely welcomed as an act of good Canadian citizenship. The non-resident parent of a company with "a degree of Canadian ownership" will be

very harshly penalized by comparison with those non-residents parents who retain a wholly-owned Canadian subsidiary.

Not only is "fair play" involved, serious as this is, but Canada will be penalized directly by a loss of investment. Any imposition of capital gains tax to non-residents will appear doubly uninviting to an outsider who is always free to exercise his choice in new investments. In all presently conceivable circumstances, no credit in his own country will avail for any quinquennial taxes imposed. In equity, tax relief should be provided to non-residents for both realized and deemed losses. But, as a practical matter, would the Canadian government pay tax refunds perhaps running into the hundreds of millions to non-resident parents should there be a decline in the values of their Canadian investments?

To apply such a tax will be extremely difficult administratively. Under Article VIII of the Canada/United States Reciprocal Tax Convention and corresponding sections of other treaties, non-residents of Treaty countries will, in any event, be exempt from any capital gains tax unless the applicable treaty is either abrogated or modified. Quite apart from the quinquennial tax factor, any rate of capital gains tax applicable beyond the limit in the investor's country against which a credit might be obtained, will be a positive deterrent to the export of funds to Canada for investment here. This enormous disadvantage could be overcome if the ultimate capital gains tax levy was imposed on actual realization only and at rates no greater than those applying elsewhere.

The Treaty modification will mean, of course, at very least, that Canadians investing in U.S. securi ies, as they so often do, will be subject initially on realization of any gains to capital gains tax in the United States. Unless those charged with the re-negotiation where both skillful and highly fortunate, Canadian investors would thereupon become subject to heavy capital gains taxes which are retraoactive in effect and which are not neatly limited to the appreciation in value since the post-valuation period. In the end result, apart from the accidental and inequitable incidences of taxes between one Canadian and another, some substantial portion of what has been estimated to be the revenue accruing to the treasury on capital gains account would accrue to the United States rather than the Canadian government. To the extent U.S. capital gains taxes were applied to pre-Valuation Day gains, they would probably not be creditable against Canadian tax and if they were, a serious drain would be imposed on the Canadian treasury.

The perils of treaty re-negotiations are illustrated by the recent experience of France. It adopted a corporate tax integration system involving refunds to the French shareholders only. In the resulting treaty revision, as a consequence of the strong bargaining position of the United States government representing exporters of capital, the resultant modifications have brought into effect a system under which the French government is obliged to refund corporate taxes to United States shareholders in French corporations effectively on the same basis as is available to French residents! The refund rule has now been broadened to apply to non-residents generally. Such an experience, which the White Paper views as intolerable, should serve as a fair warning that some of the central White Paper proposals involve risks that are not worth undertaking.

Owner-Occupied Housing

When a family strives to own its own shelter, this is not for commercial purposes but for basic social needs. Due to inflation, property sales frequently show dollar profits—even though the vendor clearly does not have an increased ability to pay—taxes, insurance or anything else. For this reason, Imperial agrees with the public statement of the Minister of Finance that owner-occupied housing should not be liable for capital gains tax—even at a reduced rate. The exemption should, however, be absolute rather than via the backdoor route set out in the White Paper.

The British Finance Act, it may be noted in passing, exempts any gains made on the sale of the disposer's sole or main residence.

Emigration of Canadians and International Transfers of Employees

The size of the differentials between Canadian and U.S. personal income taxes was not properly revealed in the White Paper. In fact, the comparisons made were, in our opinion, based on extremely quationable assumptions and for that reason are very misleading. In proof of this statement, the attached Tables 4-8 compare a resident of Ontario with a resident of New York or Ohio. The U.S. assumptions and tax calculations were made by informed and competent persons in that country. In all income ranges examined, from \$10,000 to \$100,000, the Ontario resident's

taxes would be considerably higher than the White Paper comparions would indicate, vis-à-vis his New York State counterpart, and substantially higher again than the taxes of an Ohio resident.

The impact that tax differentials of this size may have on influencing Canadian, particularly the highly-qualified technical, professional and middle-management personnel whose rates would be the hardest hit, as to whether their careers should be pursued in Canada versus the United States, cannot be overlooked. The White Paper's almost casual conclusion that Canadians would not be likely to emigrate for this reason could not be accepted—even if the disparity in rates were the only factor influencing the "brain drain". Unfortunately this would not be the case. Futhermore, the attraction or repulsion of skilled personnel from elsewhere is involved.

Quite apart from such other employment considerations as salary levels, job opportunities and prospects for advancement and diversification of experience in the two countries, a Canadian could only conclude that all major tax factors related to his employment indicated the advantages of moving to the United States. The adverse tax factors would include:—

1. The higher Canadian income taxes already mentioned above.

2. The more burdensome form of capital gains tax in Canada, particularly when considered in conjunction with the heavier gift and estate taxes introduced in 1969.

3. The fact that a tax would be payable in Canada every five years on any gains accrued but unrealized on shares of Canadian public companies.

4. The lack of any special tax consideration in Canada for stock option benefits made available by an employer.

5. The possibility that tax limitations would adversely affect the size of pensions related to Canadian employment.

6. The method of treatment of pension earnings at potentially discriminatory or arbitrarily flexible rates if an individual becomes a non-resident of Canada following retirement. (1.46.)

These same considerations would hinder and interfere with internatiinal transfers of employees both into and out of Canada. The need for such international movement of people is obvious. Canadian technical, professional and management personnel possess skills which are frequently in demand in connection with new developments and enterprise in other countries. Their increased skills are of advantage to Canada when they return to this country. Canada, in turn, has a continuing need for the special skills and services of foreign nationals. These international assignments are often relatively short-term, involving periods of up to two or three years, but also may involve considerably longer time intervals.

If the White Paper proposals are adopted, Canadians would be forced in many instances to reject the opportunity for foreign assignments. Acceptance would involve the necessity of paying tax prior to departure from Canada on all accrued but unrealized capital gains. On shares of public companies, tax would be payable on paper gains each five years whether a Canadian emigrated or not, so emigration might appear to merely result in an earlier tax payment with regard to those particular securities. In fact, however, the market value of the shares could very well decline in value before his next quinquennial birthday. For all other assets or investments the Canadian emigrant's position could be much more severely affected.

Consider, for example, the capital gains tax implications related to ownership of a private residence and summer cottage by a Toronto resident departing for New York on a two-year assignment. The Toronto residence has escalated sharply in value so that its current market value substantially exceeded its cost basis for capital gains tax purposes. The "rollover" privilege mentioned in paragraph 3.20, permitting a taxpayer to defer the payment of tax on profits realized from the sale of his home if he moves from one area to another within Canada, would not be available. On departure from Canada tax would become payable on the full amount of the gain in value of his Toronto residence. Unless he used savings from other sources, the departing Canadian could not purchase housing of an equivalent value in the New York area since part of the proceeds from the sale of his Toronto residence would be required to pay the capital gains tax. In order to avoid the tax penalties of being resident of both countries during his two-year assignment, the Canadian realizes that it would be advisable to sell his summer property. This has escalated in value even more sharply than his Toronto home. His intention, on return to Canada two

years later, would be to acquire another summer cottage equivalent at least to the one he was forced to sell. On leaving Canada, however, the gain in value of his summer property would be fully taxed and his net proceeds, if left intact, would be insufficient for the purchase of a similar cottage when he returned to Canada. In fact, his actual opportunity to own another cottage in Canada would have deteriorated badly because the individual would probably have to use a part of his cottage net proceeds to supplement his Toronto residence net proceeds in order to purchase a New York area home. On return to Canada his capital would have been seriously eroded and he would undoubtedly find it necessary to resort to substantial borrowing in order to obtain another cottage. From the Canadian's point of view such a foreign assignment would have to be rejected. He could not agree to accept the adverse financial results. The prospect of either eroding savings or incurring debt on eventual return to Canada, merely to have the same calibre of city and resort properties he had previously enjoyed, would be a dismal one.

Persons from abroad, when offered a similar employment assignment in Canada, would also be influenced to reject the prospect unless the employer included substantial additional financial reward. A U.S. citizen would not relish the higher Canadian income taxes, the heavier bite of capital gains tax, and particularly the prospect of paying tax on any unrealized gains accruing during his period of Canadian residence. The capital gains tax in Canada would, of course, apply on his return to the United States not only to gains accrued on shares he purchased while resident in Canada, but also to the unrealized gains accruing on any investment portfolio of equities which he brought to Canada with him (which would likely be U.S. securities) and merely held intact during the period of his Canadian assignment. This Canadian tax could not conceivably be offset against American capital gains tax on a subsequent disposition of the assets because:—

(a) The Canadian rate would be double the American rate,

(b) The timing differences would not permit it, and

(c) The United States would not recognize any part of the gain as Canadian-source income.

Increased Administrative Burdens

The increased administrative burdens proposed by the capital gains tax fall into four areas and will cause considerable confusion for those who are not skilled in record keeping:—

1. The computations of tax under the quinquennial scheme will be very puzzling for the uninitiated, particularly where purchases or sales have been made in the intervening period. This is illustrated by Table 9.

2. Many home and other property owners will expect to have a deduction from the sale price of their properties for "...the cost of the improvements he has made" (3.19). Very few of them will be able to distinguish between items of a repair nature, such as painting, which in the long run are not improvements and other items which have a long-term value. In the absence of a system of periodic audits of such records, many taxpayers will no doubt find themselves in a position where they believe they are being unjustly taxed.

3. Businesses will have to obtain and keep records of the values of all their properties at Valuation Day—a most difficult and time-consuming task.

4. The above problems will become almost intolerable for the heirs of a deceased. They will not necessarily know the cost of a property to the deceased, nor the cost of improvements made by him to the property, nor will they have the knowledge necessary to pick out such information from the records of the deceased—even if they are made available to them. In not all cases of the settlement of estates are the complete records of the deceased turned over to each and every legatee.

CORPORATE TAX BURDENS CANADA VERSUS UNITED STATES

The combined rates of federal and provincial corporate income taxes in Canada range from 50% to 53% and average out at about 52%. Contrary to the White Paper paragraph 4.35 comparison (which mentioned a 50% rate), this is higher than the United States combined federal, state and municipal income tax rates which after December 31, 1970 will range from 48% to 52% and average out at about 50%. It should be remembered that

some states do not levy corporation income tax and that the taxes which are levied are deductible in computing federal income tax. The differential would be extended to a slight degree for large companies and a little more so for smaller companies by the proposed elimination of the lower brackets on corporate rates, provision for which still continues to exist in the United States.

The ability of Canadian companies to successfully compete in domestic and world markets, an acknowledged objective in the White Paper itself, must be seriously questioned if this added cost burden is permitted to continue.

THE SEMI-INTEGRATION PROPOSAL FOR WIDELY-HELD CANADIAN COMPANIES

This proposal has been presented in paragraphs 1.42 to 1.44 and elsewhere as an incentive for Canadians to invest in Canadian corporations and as a fairer method of treatment of lower income shareholders than the present dividend tax credit. The idea is at first glance intriguing and ingenious. However, it is merely a clever but complicated scheme with little to commend it. The present 20% dividend credit substantially reduces the double taxation of corporate income, is simple to understand and easy to work with; it gives an equal incentive to the purchase of any dividend-paying Canadian stock.

Recommendation

We recommend that the present system be maintained—at least for widely held companies. If it is desired to increase "...incentive to Canadians to invest in Canadian corporations" (4.42), the dividend credit could be increased to 25%.

Single Tax Theory

Essentially the White Paper proposal adopts within its limited application a compromise (and for closely-held Canadian corporations a full) application of the single tax theory long applicable in the United Kingdom and now discarded there as being no longer appropriate. It comes at a time when prevailing economic theory no longer accepts the old simplistic notion that the incidence of corporate tax falls exclusively on the shareholder. In large measure, it proceeds on the implied assumption that this theory is perfectly applicable to closely held corporations and half applicable to widely-held corporations.

The Equity of Flat Rate Tax Credits

The explanations given in the White Paper are almost entirely subjective in nature and must be so valued. However, the criticism therein of the present flat rate dividend credit or rate reduction on the grounds that it is less fair than the proposed scheme is most surprising. Social welfare oriented critics of the present system of personal exemptions claim that personal exemptions favour the more highly taxed rich. They urge that personal exemptions be replaced by tax credits which would not favour the rich over the poor. Now in the name of equity, flat rate tax credits (which give greater proportional relief to the low than to the high incomes) are held to be inequitable!

The purpose of these comments is to leave aside such philosophical considerations and compare the proposed scheme of integration with the present system of dividend credits.

The Position of the Operating Company

From the point of view of many widely-held corporations with less than full creditable tax, the proposed scheme will be far less attractive than the present 20 per cent dividend credit. As noted below, the reasons why corporations will have less than full creditable tax are the outcome of deliberate government policy. Nevertheless, their shareholders would be denied the full benefits of integration and their dividends would therefore be more heavily taxed than dividends from companies with full creditable tax. This heavier taxation on the shareholder is a form of discrimination between different companies—all of which have paid the full tax imposed by law. it will be reflected in a lower price for the shares of such companies. This price influence, together with the depressing effect of the quinquennial tax (which will bear on widely-held companies but not on their closely-held competitors), will make it more difficult for widely-held companies with less than full creditable tax to raise equity money in the Canadian market.

The Worsened Position of Many Ultimate Shareholders

Table 10 compares the taxes payable on a dividend of $100. by taxpayers in various ranges of taxable incomes under the new scheme as compared with the present depending upon the proportion of creditable corporate tax available for the dividend. It appears that over a very broad range of taxable incomes, i.e., from $6,000 on the present scale

to $60,000 on the present scale, the taxes payable under the new scheme will be greater than under the present system unless creditable tax is available in amounts of practically 40 per cent of the dividend or greater. At incomes above $60,000 the taxes payable under the new system will always be greater than under the old unless or until the high rates of income tax are reduced to the 51.2 per cent level. Something like 80 per cent of the dividends received by Canadian taxpayers are received by those in the taxable income ranges of $6,000 per annum and up. The comparison in Table 10 ignores the higher taxes due to the loss of shareholder depletion and the fact that the gross-up procedure will put many taxpayers in higher brackets than they are at present. To break even such taxpayers will require greater amounts of creditable tax than the amounts shown on Table 10.

In these taxable income ranges of $6,000 and up, the greatest proportionate increase in marginal after-tax income on fully creditable dividends is in the $10,000—$12,000 range where it is 9.3 per cent. At ranges below and above this, the percentage increase in marginal income is lower. It drops to 5.9 per cent at $25,000 taxable income and 2.5 per cent at $40,000 ($35,000 on the new scale). At income tax rates in excess of 60 per cent (i.e., before the top personal tax rates are reduced), there is an increase in taxes payable under the new scheme. Assuming that all dividends were fully creditable (which they are not) and that there were no offsetting factors, the greatest possible overall increase in after-tax incomes in these taxable income ranges would be about 6 per cent or 7 per cent.

Creditable Tax May be Less Than 50 per cent

An examination of the financial results of a great many companies reveals that while there are many which will have 50 per cent creditable tax for their shareholders there are also many (including many very large ones) whose creditable taxes will be less than 50 per cent. Whether taxpayers will benefit from the new scheme depends entirely on where their funds are invested. A check made of five actual existing real life portfolios, whose owners' marginal rates are over 50 per cent, indicated aggregate creditable taxes in the ranges of 32 per cent to 39 per cent. This suggests that these and other taxpayers will lose as a result of the change rather than gain. Whether taxpayers as a whole will gain or lose will have to wait until tests or checks are made of weighted representative groups of stocks, such as those contained in the Toronto Stock Exchange averages or Dominion Bureau of Statistics averages.

"Refunds" to Middle-Income Taxpayers

On the other hand, if taxpayers can arrange to have all their income from shares of companies whose dividends carry a 50% credit, substantial cash refunds would be paid on cash incomes of $10,000 per annum (single $564.80—married $1,121.60). At $15,000 the refund for a married couple would be $349.92. No tax would be paid by a single person on an income of $13,456.07 or by a married couple on an income of $16,830.12. Table 11 compares the refunds proposed to be paid to such persons with the taxes they would pay today.

No Incentive to Invest in Electric, Gas or Steam Utilities

No incentive at all is given by this proposal to Canadians to invest in the shares of electric, gas or steam utilities or companies which have not paid tax in the 2½ years preceding the payment of the dividend.

2½ Year Payout

The 2½ year "shelf-life" of creditable tax combined with the penalty on shareholders from lack of creditable tax will create undesirable pressures on public corporations to vary their dividends in line with their income tax payments. This will reduce their room for manoeuvre and ability to maintain the steady dividend flow which is so desirable for low income shareholders who need their dividends to buy necessities. Shares of companies with fluctuating income tax liabilities will become "rich men's stocks" since low-income investors will not be able to afford to hold them.

Stock Dividends and Residents

The suggested scheme of stock dividends would permit low-income taxpayers to claim tax refunds from government at the cost of additional taxes payable by those in the higher brackets. No doubt some shareholders' meetings will become more lively with quarrels over dividends policies! There has been no comment on the social desirability or otherwise of these payments and refunds.

Further, we believe that there is no reason to suppose that provinces presently levying personal income taxes in excess of 28 per cent will cease to do so. Accordingly, the payment of stock dividends by closely-held companies

will pose a continuing problem to shareholders taxed at more than 50 per cent. Upper-income shareholders of widely-held companies will, of course, suffer from stock dividends and, paragraph 4.37 to the contrary, will either resist the declaration of stock dividends or demand extra accompanying cash to pay the tax thereon.

Stock Dividends and Non-Residents

The effect of stock dividends on non-residents was not referred to in those paragraphs of the White Paper, such as 4.26 and 4.37, which indicated that tax refunds would be available for low income Canadian recipients of stock dividends. Nor is there a reference to this in Chapter 6.

Paragraph 4.26 stated that taxpayers would not be "...forced to pay tax at a time when they lack means to satisfy the tax liability", and paragraph 4.37 "... the process should not by itself force corporations to pay out in cash a higher proportion of their profits than they would under the present system."

We believe that if stock dividends are paid by widely-held or closely-held companies to non-residents:—

(a) the withholding tax under Part III of the Act will be exigible,

(b) the non-resident will demand cash dividends to pay the tax and,

(c) the system will accordingly cause a drain on corporate cash.

Stock Dividends and Life Tenants

The relative positions of life tenants and remaindermen with regard to stock dividends is also very confused. Is the life tenant to pay income tax on a stock dividend which may enure to the benefit of the remainderman? In any event, where would the money come from?

Charities Will be Adversely Affected

Those charities which must distribute 90 per cent of their income to keep their tax-exempt status will be forced to sell their stock dividends or other investments in order to comply with the law. But if their investments are shares of closely-held companies, will there be a market for them? If there is a market, will the price bear any resemblance to the amount of the stock dividend on which they are taxed? Will the sale be possible without changing the closely-held into a widely-held company?

In addition, of course, the charity will suffer if its dividends from a holding company are reduced by intercompany dividend taxes paid by the holding company. This tax is described below.

More Difficult for the Taxpayer

The new scheme is much more complicated for taxpayers than the present system. While this may not be a problem for chartered accountants, it will be a burden for taxpayers not so trained. Executors and trustees preparing T3 returns and other taxpayers preparing their T1 returns will not be able to rely on their cash records for basis data but will have to rely on T5 slips. Errors appearing in them (as happens today) will be more difficult for the taxpayer to catch.

The preparation of T3 returns for the many estates and trusts which do not report their incomes on a calendar-year basis will be absolutely impossible unless separate T5 slips are prepared for and mailed out with each separate dividend. To get the system working properly, this would have to take effect with the January 1971 dividends.

Another awkward feature of the new scheme is that a dividend recipient's tax liability can fluctuate unexpectedly and widely. As Table 10 shows, at the new $5,000—$7,000 level the tax could range from zero to 33 per cent of the dividend depending on the percentage of creditable tax—a factor over which the recipient could have no control and would have little, if any, advance notice. For those whose income consists largely of dividends from a few Canadian companies, computing their quarterly instalment payments could be a financial nightmare. Investing in higher yielding American stocks might prove less nervewracking. At least the tax liability could be estimated fairly accurately in advance.

The Intercompany ("Upstream") Dividend Tax

The achievement of the results set out above has moreover a considerable price. The price is the "upstream" dividend tax which will be payable by holding and other companies on dividends received by them from companies which do not have a full 50 per cent creditable tax (see paragraphs 4.57 and 4.58). The reasons why the operating companies which can and do pay dividends will frequently not have the full 50 per cent creditable tax include factors all of which are specifically approved in the White Paper or arise under other existing legislation, such as

capital cost allowances in excess of depreciation deducted in computing profits reported to shareholders, income from controlled subsidiaries in Treaty countries, depletion allowances, scientific research and regional development grants payable by the Government of Canada and the realization of pre-Valuation Day capital gains. In other words, what the White Paper specifically gives with one hand to operating companies, it takes from their shareholders with the other hand. This is shown on Table 12.

While one-half of these "upstream" or intercompany dividend taxes would increase the creditable income tax available to resident Canadian taxpayers, the other half would not. None of these "upstream" dividend taxes would be of any benefit to nonresident shareholders or Canadian pension plans or Canadian charities. One can only speculate as to the effect of this "upstream" dividend tax on existing Canadian holding companies, including the proposed Canada Development Corporation. The reduction in amount available for dividends to shareholders is shown in Table 13 which is based on paragraphs 4.58 and 4.59.

The Effect on Canadian Investment Patterns

The effect of these proposals, if implemented, together with the comparison proposals on capital gains tax, on Canadian share prices and on the holding patterns of Canadians is not clear. Certainly there was a small (about 5 per cent) but short-lived rise on the Toronto Stock Exchange immediately after November 7th. Whether this is the full reaction or not, and how much of it is due to the tighter investment restrictions on pension funds, is hard to say.

The withdrawal of the dividend credit incentive from electric, gas and steam utilities and fast-growing, low-income taxpaying companies should make them less attractive to Canadians, lower their prices and so make their ownership by non-residents more attractive.

Similarly, the slightly reduced taxation of dividends from high taxpaying (presumably mature) companies should make their shares more attractive to Canadians. The resultant slight increase in price could induce some non-residents to sell.

Working together the two influences should cause somewhat of a switch by Canadian investors from growth to mature stocks with a reverse movement by non-residents. While the extent of the switch is unknown, the direction is, we believe, definitely wrong.

This unfortunate result of the proposed semi-integration scheme is reinforced by the proposed capital gains tax. Hitherto, Canadians in weighing the advantages of preferreds and other mature income stocks, as opposed to those of low-dividend, growth stocks, have not been taxed on any gains realized from holding growth stocks. The capital gains tax, in its extreme quinquennial form, will bear more heavily on the growth stocks than on the preferreds and mature income stocks. It will accordingly shift the focus of investment somewhat further from growth to payout.

Intercorporate Holdings—Closely-held Versus Widely-held

In the effort to draw a sharp distinction between closely-held and widely-held Canadian corporations a flaw emerges at the level of intercorporate holdings. Integration becomes very difficult to apply once there is more than one effective rate of tax. We imagine that this contributed to the decision to abolish the dual corporate rate as it applies to smaller corporations. But the semi-integration proposals demand the reintroduction of a new kind of dual rate which breaks down more and more as one delves into intercorporate holdings. The present relatively simple principles embodied in Section 28 of the Income Tax Act, effectively eliminating almost all tax on intercorporate flows, would be replaced by a complicated and expensive alternative which cannot be justified.

Under the proposals an individual receiving a dividend out of creditable tax from a closely-held Canadian corporation would, unless his marginal rate exceeded 50 per cent, pay no tax whatsoever (and at lower brackets would be entitled to a refund). Suppose now that a shareholder beneficially owned a share interest in a closely-held Canadian corporation through the interposition of a widely-held Canadian corporation. His effective tax rate on the flow of dividends is much higher because the semi-integration formula automatically applies on the widely-held Canadian corporation flow-through of dividends irrespective of the origin. There is no rhyme or reason to this. The White Paper tries to explain the reason for the distinction at the first level between a tax-free distribution out of creditable tax in a closely-held Canadian corporation and a one-half tax-free distribution out of creditable tax in a widely-

held Canadian corporation. There is no effort to explain the increase of the tax on the dividend which would result because of the interpostion of a closely-held Canadian corporation owned by a widely-held Canadian corporation.

An extra problem arises in contrasting a direct gain by an individual from the sale of shares of a widely-held Canadian corporation where the maximum rate is 25 per cent with the higher rate that would apply if the gain was routed through a widely-held corporation or a closely-held Canadian corporation which could not qualify for a partnership election. What is the possible justification for such a sharp discrepancy? A company which enjoyed the advantage of a partnership election might suddenly lose it in an ensuing year because a shareholder with less than 1 per cent of the stock might be recalcitrant or was a daughter of the principal owner and married a resident of the United States (4.22-4.23).

There may be some case for the single tax as it had long been applied in England or the double tax as it has been applied in the United States and, to a lesser extent, in Canada, but a combination of the two systems with a creditable tax being free when it emanates from a closely-held Canadian corporation and half taxable when it derives from a widely-held Canadian corporation becomes completely unjustifiable when different stages of intercorporate holdings are involved.

Owners of shares in closely-held Canadian corporations will have an enormous disincentive, over and above the formidable one already presented by the quinquennial tax prospect, against going public and seeking wider participation and expansion of their enterprise. The theoretical basis for the distinction between the two types of companies that "by and large" closely-held corporations compete with closely-held, and widely-held corporations compete with widely-held (4.19) is far removed from reality. The whole integration concept with its distinction between widely-held and closely-held is much more complicated in its application and far inferior in its results to the system presently applying under Section 28 of the Income Tax Act.

Summary

To summarize, if the White Paper semi-integration proposals replace the present dividend credit (and ignoring the effect of loss of shareholder depletion, changes in personal tax rates and capital gains taxes):—

(a) A great many dividend recipients will pay more tax on their dividends—perhaps a majority, while some will pay less.

(b) The share values of many widely-held companies will decline, making financing more difficult.

(c) Some dividend recipients well above the poverty line will have their income taxes wiped out and even converted into substantial "refunds".

(d) While the incentive for Canadians to hold certain Canadian stocks will be somewhat increased, the incentive to hold other Canadian stocks, i.e., certain utilities and low taxpayers, will disappear or be substantially reduced.

(e) Stock dividends, if paid, will complicate matters.

(f) An "upstream" or intercompany dividend tax will appear.

(g) Charities, pension plans and non-residents will be hurt by the intercompany dividend taxes and probably by the stock dividend proposals.

(h) Tax compliance will be more difficult for the taxpayer as well as the assessor.

THE LOW RATE OF TAX ON SMALL BUSINESSES

The abolition of the low rate of tax on the first $35,000 of taxable income is a completely unnecessary blow at expanding small businesses. It reflects resignation in the face of draftsmanship difficulties in limiting application of this worthwhile rule so as to exclude its occasional abusive extension, but the current rules are tighter than ever and the reaction on this score is no longer a valid one. Indeed, the drafting problems pale into insignificance by comparison with some of the complicated proposals entailed in applying other recommendations on the White Paper.

The policy objective we recommend should not be to abolish this useful device for assisting small businesses. The objective should be to see that the favourably taxed earnings are retained in the business and are not bled out by subterfuge or low cost backdoor routes.

Based on the single tax premise which permeates the White Paper, particularly for closely-held corporations, the point is made, and it is a relevant one theoretically if the premise is accepted, that total tax should be measured not only by the portion exigible at the corporate level but also in relationship to

that which is distributed. In the long run this is quite correct. But it is equally to be qualified by the apt observation of John Maynard Keynes in another connection that "In the long run we'll all be dead".

Some small corporations manage to survive and expand in the short run. The struggling entrepreneur operating the small growing corporation is rarely, if ever, in a position to make any distributions of earnings because of the constantly impinging requirements of capital to finance any expanding operations. Growth is only possible in those cases if capital is available and a major portion of this must be generated out of retained earnings plowed back into the business. To tax at the earlier point before the funds are freely available for distribution is to stultify the growth of many such corporations which in the past have made dynamic contributions to the Canadian economy. One has only to analyze the financial statements of a cross section of these types of companies to appreciate that funds are simply not readily available for distribution to shareholders and to measure the tax base applicable to them as though they were is perforce to prevent them in many instances from becoming individually and collectively successful growth companies. Wat counts for them is not so much the aggregate taxes payable by the corporation and the shareholders when all the earnings have been distributed, but rather the timing of the exigibility of the tax. At least inferentially, this is acknowledged in the White Paper (4.18). The current low rate on the first $35,000 of taxable income enhances the survival prospects while retaining taxability on distributions if, as and when they are made.

To suggest that the minimum rates on the first $35,000 may be a "benefit" to large corporations is merely to affirm that the current rate of 53 per cent of combined federal and provincial corporate taxes in the central provinces is effectively adjusted downward by a relatively slight fractional percentage point which progressively diminishes as their total net income rises. At $1 million of revenue the 53 per cent rate becomes 52 per cent when account is taken of the lower rate of tax on the first $35,000 and at $10 million it becomes a shade over 52.9 per cent. Whilst the large companies would gain substantially in tax savings if the corporate tax were equalized at the suggested 50 per cent for all corporations, it would not appear to be in the best interests of Canada to deprive the small corporations of the modest capital accumulation opportunities available under the current system.

If, for some reason, it was found necessary to withdraw the low rate from larger companies—although this would be in the direction of further distinguishing the two rather than their equalization as proposed in the White Paper—this could be done by providing one or two minimum points (with a suitable notch provision in the former event) beyond which the low rate would not avail for any portion of the income, or if the proposed distinction between closely-held and widely-held companies is found to be workable, the low rate could in such event simply be withdrawn from widely-held companies. Because in this intance it would slightly discourage at marginal levels companies from going public this type of change would appear to be a minor step backward.

LOSSES CREATED BY CAPITAL COST ALLOWANCES OR PROPERTY TAXES

The chapter on Business and Property Income offers some interesting innovations in the area of "nothings" with which we are in general agreement. Since it is suggested that general consideration of capital cost allowance rates be deferred until later, we are not submitting any observations on this subject. However, some of the wording in this chapter is capable of an extremely broad interpretation—far beyond what we believe is intended. We trust and assume that the enacting legislation will be more specific and less far reaching.

The second proposal at paragraph 5.17 is set out against a background of individuals offsetting property losses against personal income. However, the language used appears to be broad enough to cover a great many other types of rental properties, including dwelling units and office space owned by corporations, service stations, branch bank buildings, as well as automotive and other equipment. Imperial Oil Limited currently owns and rents out to its dealers over 1,500 service stations. These holdings have nothing to do with the search for any tax shelters from other income. They are held and employed as essential parts of our business and all the costs incidental to their ownership and operation are incurred as an integral part of our marketing operation.

The proposal could conceivably also affect situations in which a multiplicity of assets is erected on a single site by one corporation, as an integrated development complex having on-going investment. Such developments are under one ownership, one operatorship and one overall authority although there may be more than one structure. Tentants leasing space from the owner/operator share a range of common costs, utilities and services, etc., as part of the overal ocupancy according to predefined leases, the general form of which applies to all tenants.

If 5.17 is implemented, it may be necessary for the owners of such properties to compute and analyse the profits and losses of each building, piece of equipment, store or other rental space separately in order to determined whether or not losses exist which have been created by capital cost allowances or property taxes. Once it has been determined that losses have been so created, 5.17 may disallow them.

In our opinion, the disallowance of such losses to a corporation, either on an overall or on an item-by-item basis, goes far beyond what is justified by the problem stated in the White Paper.

Furthermore, the proposal, as written, appears to contemplate the disallowance of capital cost allowance on industrial machinery and plant while it is under construction. It is hardly necessary to state the powerful incentive to desirable industrial expansion provided by the present capital cost allowance provisions. In this respect, 5.17 seems to destroy what 5.14 has expressly stated will not be disturbed for the present.

As stated earlier, we assume and trust that these extreme examples mentioned here go far beyond what is intended.

THE CANADIAN OIL AND GAS INDUSTRY

Restricting depletion to one-third of eligible exploration and development expenditures would seriously reduce the depletion allowance on future production. This would result in an increase in the tax on producing income of up to 50 per cent—it is retroactive in effect and it is inequitable.

This increase in taxation would hurt the economy of Canada by acting as a disincentive to exploration and development. The gain in government revenue from this tax increase would be small innrelation to the economic growth which would be sacrificed.

RECOMMENDATIONS

1. We strongly recommend that depletion be implemented as a percentage of gross income from production at a rate at least competitive with the current United States rate and limited to an appropriate percentage of net producing profit. This form of depletion allowance would promote exploration by rewarding successful effort rather than by subsidizing spending as the White Paper proposes. It would also eliminate some of the undesirable aspects of the present system.

2. If it is decided to limit the present depletion system by reference to the level of exploration and development expenditures, we recommend that:—

(a) The transition period be 10 years for both operators and non-operators (i.e., royalty holders).

(b) The limitation be altered to one dollar of depletion for each two dollars of eligible exploration and development expenditures.

(c) The cost of acquiring Crown mineral rights and all classes of development expenditures be included as eligible expenditures in the calculation of depletion.

SUBMISSION

Need for Special Rules for the Industry

We agree with the White Paper that special taxation rules should apply to the oil and gas industry:—

(a) Because exploration involves ". .more than the usual industrial risks and the scale of these risks is quite uncertain in most cases." (5.24.)

(b) In recognition that exploration and development "...provide special benefits to Canada and to various provinces by creating or maintaining highly productive industry in areas other than those where rapid urban and industrial growth are already occurring..." (5.24.) We would emphasize that these special benefits are particularly significant at this time when new concepts and opportunities in North American oil policy appear to be emerging.

The White Paper did not mention the additional substantial benefit represented by the large contributions to government revenues that the producing industry makes in non-income tax areas such as production royalty

payments and payments to acquire and maintain Crown mineral rights. For the year 1969, these payments totalled some $350 million for the industry as a whole. Imperial Oil alone paid $27 million. When corporate income taxes are added, the total contribution of Imperial Oil's producing operations in support of government revenues for 1969 was $56 million. For the oil and gas producing phase of Imperial Oil's operations, this represented an effective tax rate of 48.7 per cent.

Another important feature of the oil and gas industry that is largely ignored by the White Paper is the industry's contribution to Canada's balance of payments. In 1947, Canada imported almost all of its requirements for oil and gas. The cost was $400 million. The cost of importing all the oil and gas consumed in Canada in 1968 would have been $1.8 billion. The oil and gas industry has grown to the extent that the value of exports now exceeds imports by some $250 million per year. Canada's large undiscovered reserve potential and the encouraging outlook for continuing growth in export markets indicates that the balance of payments credits will continue to grow provided the investment climate is not diminished.

The Wasting Nature of the Asset Being Produced

Historically, the depletion allowance has served as an income measurement device to avoid taxing a miner or an oil producer on the capital being returned to him as the ore or oil is produced. The White Paper proposals ignore this completely since, after 1975, no depletion would be allowed to an operator who does not carry on exploration after November 7, 1969—no matter how much he may have done before that date or how great the value of the deposit which is being exhausted.

The Proposals Will Reduce Growth

Despite these recognized benefits that accrue from a viable oil and gas industry, the White Paper recommends a depletion system that would reduce the growth of the industry below that which would apply under present taxation rules. This is because:—

(a) The explorer would recognize that, despite the fact that he would qualify for some depletion as a result of new exploration expenditures, he would ultimately be faced with higher tax payments. How much higher would depend on the relative magnitude of the anticipated successes and the necessary expenditures.

(b) The greatly increased taxation burden on income from both past and future investments would reduce the cash flow available for future exploration.

(c) The Canadian shareholders of a mine or an oil producing company would be hurt in two ways by the White Paper depletion proposals. Besides losing the benefit of the 10 per cent, 15 per cent or 20 per cent shareholder depletion allowance, they would have their integration tax credits (4.36) reduced by up to $\frac{3}{4}$ of the tax saving accruing to the corporation from the depletion allowance. The reduced depletion benefit left with the corporation by the White Paper would be substantially taken from the shareholder. From the Canadian shareholders' point of view, such incentive to develop and explore as remains from paragraph 5.40 would be largely frustrated by Chapter 4. This is referred to further in the section of our brief entitled "The White Paper Semi-Integration Proposals". (See Table 13.)

Depletion Should be a Percentage of Gross Production

One of the aims of taxation policy should be to ensure that in the development of Canadian resources Canadian operators obtain tax incentives or benefits at least equal to those obtained by foreign operators in Canada. One of the shortcoming of the present Canadian net depletion allowance method is that it does not do so. United States operators who are taxable in the U.S. are in the position to claim gross depletion in the United States for their Canadian operation even though the latter may be in a non-tax paying position.

In past submissions to the Canadian government, Imperial Oil has argued that net depletion acts as a disincentive to exploration. The White Paper agrees with this conclusion. At paragraph 5.39 it says "Because exploration and development costs must be deducted in computing production profits for this purpose, the operator of a mineral resource can logically claim he is inhibited from engaging in exploration by the rules concerning depletion. The exploration costs reduce the depletion allowance: therefore it can be argued that the provision designed to increase

exploration can in some cases reduce it." Nonetheless, the White Paper continues this very same disincentive formula. Under present legislation, undertaking exploration on any other property and in any other province or area reduces the depletion available from existing operations. This produces the incongruous situation whereby the more a company spends on exploration, the less it receives as a depletion allowance. After discovery of an oil or gas filed, the full benefit of depletion is achieved only if further exploration ceases.

To overcome this disadvantage, we urge that the present one-third net depletion allowance be replaced by a gross depletion allowance at a rate at least competitive with the current U.S. rate of 22 per cent and limited to an appropriate percentage of net producing profit before deducting exploration expenses. After full discussion over an extended period, the United States has retained the system of gross depletion. While the rate for conventional oil production was reduced from 27.5 per cent to 22 per cent, the allowable depletion for mined oil shale was effectively more than doubled. The more efficient system we recommend would:—

(a) Eliminate the "depletion penalty" that the present system imposes on exploration expenditures.

(b) Improve the ability of Canadian firms to compete with branches of U.S. corporations.

(c) Reduce the depletion allowance benefits accruing to operators whose exploration program is small in relation to their profits from production.

The White Paper recognizes (5.38 and 5.39) the desirability of points (a) and (c), but its proposals would only be fully effective with regard to point (c). They would not be as effective as a gross depletion allowance in accomplishing the first two objectives. Gross depletion achieves the two stated aims of the White Paper and contains none of its disadvantages.

Depletion should reward success in order to be an efficient incentive for risk-takers. Instead, the White Paper proposes to reward mere spending—even unsuccessful spending can increase the allowance. This is equivalent to granting subsidies on spending whereas gross depletion increases the value of the prize if successful. We believe that the latter is a more efficient incentive.

Gross depletion at rates comparable to the U.S. rate would not discriminate against revenues from past investments as severely as would the White Paper. It would, as compared with the present depletion method, reduce the allowance available to companies who do little or no exploration or development.

In summary, our opinion is that gross depletion at a rate competitive with the United States would provide a more satisfactory solution to the depletion issue than either the current arrangement or the proposed limitation of depletion.

The Proposed Change Has a Retroactive Effect

A most disturbing feature of the White Paper recommendations is the drastically higher tax burden that would be placed on income from many past investments. Any measures of this type operate as a disincentive to future investment. These earlier investments were made on the assumption that, if successful, the present depletion allowance would be deductible in determining taxable income. If the White Paper is fully implemented, the tax on income from prior ivestments would, after 1975, be increased by 50 per cent since these fully developed properties could not earn depletion. New exploration and development would earn depletion but the anticipated depletion allowance for prior investments would be eliminated.

Thus, as stated above, the oil and gas industry is faced with an increase of up to 50 per cent in taxation on future income from these prior investments. This would be a severe case of effective retroactive taxation. The rate of increase in taxation caused by adoption of the White Paper proposals would differ for each oil and gas company. It could range from zero in the case of companies which never achieve a taxable position, to 50 per cent for companies which for one reason or another do not explore but merely produce existing oil or gas reserves. In the case of Imperial Oil, a comparison of the income taxes actually paid on its producing income for the year 1969 shows that if the White Paper proposals had been fully in force during that year the income taxes paid would have increased from $29.1 million to $36.7 million—an increase of $7.6 million or over 25 per cent.

The 5-Year Transition Period is Too Short

The White Paper implicitly recognizes the severity of the tax impact on past investments and proposes a 5-year transition period. This is grossly inadequate in relation

to the normal timing pattern of oil and gas investments.

Payout on oil and gas investments is a lengthy proposition. A normal exploration cycle covers 5-10 years and, if discovery occurs, delineation and development consume 1-5 additional years before any revenue is received. The revenue is normally distributed over about a 30-year period.

The oil and gas producing industry has been investing over $700 million per year in exploration and development in recent years. A large portion of these recent investments would receive very little return by 1975.

The choice of a 5-year period appears to be an accidental selection coinciding with other admittedly arbitrary transitional periods and unrelated to the situation of the oil and gas industry.

All companies, large and small, have made their exploration and development investment decisions on the premise that when the proceeds became taxable they would qualify for the present depletion allowance.

If the White Paper limitation on depletion is adopted, despite our strong objections, we recommend that the transition period for the depletion allowance be at least 10 years.

$1 for $2 Depletion Ratio

The White Paper proposed the imposition of two limitations on depletion. First, it could not exceed the present allowance of one-third of net producing profits. Therefore, the proposal could not possibly improve the position of anyone in the industry. Second, it would be restricted to one-third of eligible expenditures. As shown in the illustration below, which expands on paragraph 5.41, this would penalize all those who spend less than 150 per cent of their net profit on exploration. If the non-eligible expenditures described below which are not reflected in the following illustration were included, the total reinvestment as a percentage of net profit would be much larger.

Percentage of eligible expenditures to net profit.....(b/g)	0%	50%	100%	150%
(a) Profits before eligible expenditures	$6,000	$6,000	$6,000	$6,000
(b) Eligible expenditures	0	1,286	2,250	3,000
(c) Profits after eligible expenditures..........(a−b)	6,000	4,714	3,750	3,000
(d) Depletion...............(lesser of ⅓ of b or ⅓ of c)	0	429	750	1,000
(e) Taxable income..........................(c−d)	6,000	4,285	3,000	2,000
(f) Income tax..............................(½ of e)	3,000	2,143	1,500	1,000
(g) Net profit..............................(c−f)	$3,000	$2,571	$2,250	$2,000
(h) Depletion under present system...........(⅓ of c)	2,000	1,571	1,250	1,000
(i) White Paper reduction of depletion........(h−d)	2,000	1,142	500	0
(j) White Paper tax increase...............(50% of i)	1,000	571	250	0
	50%	36%	20%	0%

We believe that this is an unreasonably high level of exploration to impose on the industry and that the penalty point is set too high. It would be more equitable and a more reasonable public policy to institute a penalty only if the taxpayer's exploration effort amounts to less than his net profit. This could be accomplished by allowing depletion to be computed at the rate of one dollar for every two dollars of exploration. The effect of this change is shown below:

Percentage of eligible expenditures to net profit.....(b/g)	0%	50%	100%	150%
(a) Profits before eligible expenditures	$6,000	$,6000	$6,000	$6,000
(b) Eligible expenditures	0	1,333	2,400	3,000
(c) Profits after aligible expenditures..........(a−b)	6,000	4,667	3,600	3,000
(d) Depletion...............(lesser of ½ of b or ⅓ of c)	0	667	1,200	1,000
(e) Taxable income..........................(c−d)	6,000	4,000	2,400	2,000
(f) Income tax..............................(½ of e)	3,000	2,000	1,200	1,000
(g) Net profit..............................(c−f)	$3,000	$2,667	$2,400	$2,000
(h) Depletion under present system...........(⅓ of c)	2,000	1,556	1,200	1,000
(i) White Paper reduction of depletion........(h−d)	2,000	889	0	0
(j) White Paper tax increase...............(50% of i)	1,000	445	0	0
	50%	29%	0%	0%

It is noted from the third column that a one dollar for two dollars depletion ratio would not impose a tax penalty if the taxpayer's expenditures on exploration were equal to his net profit (i.e., funds available for dividends or reinvestment). Requiring a higher level of reinvestment than that would not be reasonable.

We recommend, therefore, that if the White Paper concept of depletion is adopted it should provide at least one dollar of depletion for each two dollars of eligible expenditures.

Broader Definition of Eligible Expenditures

It is difficult to understand why the costs of acquiring mineral rights are excluded as eligible expenditures in computing depletion (5.40). The major part of these expenditures is in a high-risk category. If these outlays are not treated as eligible expenditures, bonus payments to provincial and federal governments would be lower. We understand that one of the concerns of the government was that the inclusion of such costs could lead to abuse through intercompany trading of these rights. This danger could be readily controlled by limiting the amount claimed to Crown acquisitions only and this is our recommendation.

It is not clear whether other oil and gas field development expenditures qualify as "eligible" for depletion purposes. Expenditures on equipment for productive wells, flowlines, separating and treating equipment, secondary recovery facilities and gas conservation plants are absolutely necessary to develop an oil or gas field. Since the capital cost allowances on these outlays will serve to reduce the net profit limitation on the depletion allowance, we think it only fair and conducive to development that these outlays qualify as eligible expenditures for depletion purposes.

Royalty Income

The White Paper appears to recommend the immediate elimination of the depletion allowance for non-operated or royalty income. (There is reference at 5.43 to an offsetting amortization provision which, however, is not clarified.) This would be an unfair change since the purchase price or other consideration given for royalty income has been predicated upon the continuation of the existing 25 per cent depletion allowance.

HEAVY HYDROCARBONS

THE DEVELOPMENT OF THE ATHABASCA TAR SANDS COLD LAKE AN OTHER VISCOUS OIL SANDS

The Athabasca and other Alberta viscous oil sands may be divided into two broad categories—a mineable area where overburden may be removed and the tarry oil separated from the sand and clay by mechanical methods and a deeper area where the tarry oil must be recovered through drilling wells and injecting steam or other means of softening the viscous oil so that it may be pumped to the surface. The mining system has been developed to the point where one project is in operation and another large one (Syncrude Canada Limited) is planning towards production; recovery from the deeper sands is still in the research stage.

Athabasca Mining

Imperial Oil Limited has a 30 per cent interest in Syncrude Canada Limited and endorses the submissions by that company to the Parliamentary Committees studying tax reforms. We too anticipate rapid growth in the markets for Canadian crude oil and the need for tar sands production to supplement conventional supplies by the mid-1970's. However, much of the technology envisaged for the utilization of these resources by Syncrude Canada Limited has not been applied anywhere else in the world, and even where the processes are familar many have not been attempted on such a large scale. Consequently, very large investments are coupled with very large risks. Unfortunately, with today's technology, costs, prices and under prevailing tax rules the best Athabasca tar sands prospects are only marginally attractive. To complicate matters further, the oil content and chemical composition of the sands varies sharply and unpredictably over short distances. It is therefore unlikely there would be any new Athabasca tar sands mining ventures undertaken if the proposed tax reforms were to be applied. Regrettably, the costs of constructing a plant are rising while crude prices are not. The margin for success is growing thinner—time appears to be running out for this development.

In addition, there are other features of these projects which sharply distinguish them from conventional petroleum and natural gas

operations: the huge size of the investments required ($200 to $300 million), the fact that the reserves are already located and need little further exploratory work, and the individual separate identity of each project. It is imposible for us to conceive of an investor having a continuing program of developing a succession of Athabasca tar sands mines. For this reason, the whole paragraph 5.40 concept of limiting depletion to any fraction of amounts spent year-by-year on eligible exploration and development work is quite inapplicable to this type of project. If proposal 5.40 is implemented, throughout most of the productive life of such a project applicable income taxes would be 50 per cent higher than under today's depletion rules, with a resulting severe reduction in net earnings and book returns. Accordingly, it is vital that depletion allowances be continued—either as a percentage of gross producing income or on the present basis—without the one-third of expenditure limitation set out in paragraph 5.40.

It should be noted that the Syncrude consortium (of which Imperial Oil is a member) has to-date spent some $30 million on this project in anticipation of the present tax treatment of any production profits which might result from a commercial development. We cannot imagine that outlays of this magnitude would have been made if the White Paper proposals had been fully implemented fifteen years ago. We are sure that the very substantial outlays in this area made by other taxpayers were also made with the present tax provisions in mind.

Secondly, the White Paper at paragrah 5.31 "... proposes to phase out the present three-year exemption for new mines." Due to the conditions of the permit, the delayed effect of the phase out provides no relief to our Athabasca project. An acceleration of capital cost allowances (paragraph 5.29) which would be claimable by us in any event is very far from adequate to offset the loss of or replace the three-year exemption. This proposal, if enacted, would severely impair the economics of Imperial Oil's participation in the Syncrude project.

Taken together, the two proposals, if enacted, would so reduce the attractiveness of our tar sands project that they would almost certainly kill it and in so doing largely eliminate any chance of the further development of this mammoth mineral resource to the detriment of the local, regional and Canadian economy.

Other Tar Sands and
Viscous Oil Deposits

Although that portion of the Athabasca tar sands which can be mined represents an extremely large resource, deeper tar sands in Athabasca, Cold Lake and elsewhere which are not susceptible to mining, represent reserves which are at least six or seven times larger. It is important that these vast oil deposits become productive some day also so that Canada may participate to the fullest extent in the North American petroleum demand anticipated in the 1980's. Unfortunately, the technology needed to produce oil profitably from these reserves is not available today, despite many years of expensive research. Many additional years of research will be required, both in laboratories and in the field, before an operator would be willing to invest the huge sums of money which will be required for commercial exploitation. Even after research has been completed, a further four years of heavy investment is required for field development and plant construction which means a very long and costly lead time before oil can be brought to market from these sources. The point to be made is that assurance of favourable tax treatment for a commercial venture is required in order to sustain this long term research effort.

A brief explanation of the manner of development of these reserves would appear desirable. Since they are too deeply buried to allow open-pit mining, it is anticipated that they will be exploited by the use of well equipment similar to that used in the conventional oil industry. However, unlike conventional oils, these tar-like materials will not flow into wells without a considerable application of energy, e.g., steam heat, from external sources. Once the bitumen has been produced, it has to be separated from the brine with which it is intimately mixed. It must then be upgraded to allow it to be pipelined to markets. The equipment to do this must be very large before it is economically justifiable, hence these projects will be characterized by very high costs and long construction times.

Imperial Oil, as a large holder of this type of oil reserve, has been a pioneer in conducting research into the development of this type of resource for many years on the assumption there would be no radical change in tax regulations over the long term. Despite this background, continued research would be retarded, or more likely terminated, if the prospects for a profitable operation were jeopardized through implementation of the proposed tax

reforms. This type of project has an immediate disadvantage when compared with the Athabasca mining projects in that it would not enjoy a three-year tax holiday before or after the White Paper, making it just that much more difficult to produce a reasonable return on the investment.

Recommendation

In view of the future importance of these immense resources to Canada, we would strongly urge that depletion be granted as a percentage of gross income at a rate competitive with that allowed United States deposits without the paragraph 5.40 limitation.

It is most important that this incentive be maintained on a long-term basis. It would be most unfair to an investor if, after he had spent millions on research, the allowances were withdrawn.

LIST OF TABLES

TABLE 1

THE EFFECT OF AVERAGING

AN ILLUSTRATION OF THE GENERAL AVERAGING PROVISION FOR SINGLE INDIVIDUALS WITH FOUR-YEAR AVERAGE INCOMES OF $19,600 AND OVER, AND MARRIED INDIVIDUALS WITH FOUR-YEAR AVERAGE INCOMES OF $21,000 AND OVER, ASSUMING USE OF THE $100 OPTIONAL STANDARD DEDUCTION

Income Calculations:	Single	Married
1971–1974 average	$19,600	$21,000
1975 income	48,000	48,000
Threshold amount	26,133.33	28,000
Excess of 1975 over threshold	21,866.67	20,000
Threshold + 1/5 of excess	30,506.67	32,000
Tax Calculations:		
Tax on 32,000		11,788.80
Tax on 30,506.67	11,741.00	
Tax on 28,000 threshold		9,740.80
Tax on 26,133.33 threshold	9,501.85	
Tax on 1/5 excess	2,239.15	2,048.00
Tax on excess 5 × 2,048.00		10,240.00
Tax on excess 5 × 2,239.16	11,195.75	
Tax on threshold	9,501.85	9,740.80
Tax on 1975 income	20,697.60	19,980.80
Tax on 48,000—normal	20,697.60	29,980.80
Tax on 48,000—averaging	20,697.60	19,980.80
Amount saved by averaging	Nil	Nil

TABLE 2

THE TOTAL TAX REFORM PACKAGE
THAT BEGAN WITH THE OCTOBER 22, 1968 BUDGET

	Pre-Oct. 23, 1968	Post-Oct. 22, 1968	White Paper
Estates	10% to 54% at $2,000,000	15% to 50% at $300,000 exempt bequests to a spouse cumulative feature	Benificiary takes at cost to deceased plus a part of the death taxes
Gifts	11% to 28% at $1,000,000	12% to 75% at $200,000 exempt gifts to a spouse cumulative feature	Sale at fair market value and gift of proceeds would add a capital gains tax to the gift tax. Capital gains tax would apply even on exempt gifts to a spouse
Capital gains	None	None	Would be taxed as ordinary income with some exceptions

TABLE 3

AN ILLUSTRATION OF THE RESULTS THE QUINQUENNIAL TAX WOULD HAVE HAD ON AN INVESTMENT IN SHARES THAT SHOWED AN EQUAL RISE AND FALL

Assumptions:
1. 10,000 shares of a widely-held Canadian corporation purchased last day of November 1950.
2. Investor's taxable income from all sources except the taxable gains and losses shown below is $24,000 in each year.
3. Taxpayer's revaluation dates are July 1951, 1956, 1961 and 1966, respectively.

Revaluation Date	Share Value	Total Value	Taxable Gain or (Loss)	Tax Payable or (Saved)
	$	$	$	$
Nov. 1950 (purchase date)	5.80	58,000	—	—
July 1951	7.60	76,000	9,000	4,500.00
July 1956	23.25	232,500	78,250	39,125.00
July 1961	8.40	84,000	(74,000)	(4,177.60)
July 1966	5.90	59,000	(12,500)	(5,529.60)
Net tax cost for 10c per share gain				28,917.80

TABLE 4

COMPARISON OF U.S. FEDERAL AND NEW YORK STATE INCOME TAXES WITH CANADIAN INCOME TAXES AT THE $5,000 LEVEL

(Taxpayer is married with two dependent children under 16)
(Rates anticipated for 1971)

	U.S. Federal Income Tax Calculations		N.Y. State Income Tax Calculations	
	White Paper Highlights	Imperial Oil	White Paper Highlights	Imperial Oil
Gross income	5,000	5,000	5,000	5,000
Deductions other than state tax*	600	1,147	500	1,147
State income tax	—	9	—	—
	4,400	3,844	4,500	3,853
Exemptions	2,400	2,400	2,400	2,400
Taxable income	2,000	1,444	2,100	1,453
Tax on 1st bracket	290	140	20	20
Percentage of balance	—	76	33	14
	290	207	53	34
Surcharge/(Credit)	29	**	(25)	(25)
Net tax	319	207	28	9
Social Security Tax***	240	240		
State income tax	28	9		
Total U.S. taxes	587†	456		
Canadian tax per White Paper		425		
U.S. tax over Canadian		31		
Overstimate of U.S. taxes by White Paper ($558–456)		102		

*See notes behind Table 8.
**Surcharge has been omitted from Imperial Oll calculations since it expires on June 39, 1970.
***4.8% × $5,000.
†This differs from the figure of $558 in the White Paper Highlights which we are unable to arrive at.

TABLE 5

COMPARISON OF U.S. FEDERAL AND NEW YORK STATE INCOME TAXES WITH CANADIAN INCOME TAXES AT THE $10,000 LEVEL

(Taxpayer is married with two dependant children under 16)
(Rates anticipated for 1971)

	U.S. Federal Income Tax Calculations		N.Y. State Income Tax Calculations	
	White Paper Highlights	Imperial Oil	White Paper Highlights	Imperial Oil
Gross income	$10,000	$10,000	$10,000	$10,000
Deductions other than state tax*	1,000	1,895	1,000	1,895
State income tax	—	170	—	—
	9,000	7,935	9,000	8,105
Exemptions	2,400	2,400	2,400	2,400
Taxable income	6,600	5,535	6,600	5,705
Tax on 1st bracket	620	620	160	160
Percentage of balance	494	292	80	35
	1,114	912	240	195
Surcharge/(Credit)	112	**	(25)	(25)
Net tax	1,226	912	215	170
Social Security Tax***	374	374		
State income tax	215	170		
Total U.S. taxes	1,815	1,456		
Canadian tax per White Paper		1,913		
U.S. tax under Canadian		457		
Overestimate of U.S. taxes by White Paper ($1,815–1,456)		359		

*See notes behind Table 8.
**Surcharge has been omitted from Imperial Oil calculations since it expires on June 30, 1970.
***Maximum.

TABLE 6

COMPARISON OF U.S. FEDERAL AND NEW YORK STATE INCOME TAXES WITH CANADIAN INCOME TAXES AT THE $20,000 LEVEL

(Taxpayer is married with two dependant children under 16)
(Rates anticipated for 1971)

	U.S. Federal Income Tax Calculations		N.Y. State Income Tax Calculations	
	White Paper Highlights	Imperial Oil	White Paper Highlights	Imperial Oil
Gross income	$20,000	$20,000	$20,000	$20,000
Deductions other than state tax*	1,000	3,293	1,000	3,293
State income tax	995	773	—	—
	18,005	15,934	19,000	16,707
Exemptions	2,400	2,400	2,400	2,400
Taxable income	15,605	13,534	16,600	14,307
Tax on 1st bracket	2,260	2,260	860	680
Percentage of balance	902	384	160	118
	3,162	2,644	1,020	798
Surcharge/(Credit)	316	**	(25)	(25)
Net tax	3,478	2,644	995	773
Social Security Tax***	374	374		
State income tax	995	773		
Total U.S. taxes	4,847	3,791		
Canadian tax per White Paper		5,620		
U.S. tax under Canadian		1,829		
Overestimate of U.S. taxes by White Paper ($4,847–3,791)		1,056		

*See notes behind Table 8.
**Surcharge has been omitted from Imperial Oil calculations since it expires on June 30, 1970.
***Maximum.

TABLE 7

COMPARISON OF U.S. FEDERAL AND NEW YORK STATE INCOME TAXES WITH CANADIAN INCOME TAXES AT THE $50,000 LEVEL

(Taxpayer is married with two dependant children under 16)
(Rates anticipated for 1971)

	U.S. Federal Income Tax Calculations		N.Y. State Income Tax Calculations	
	White Paper Highlights	Imperial Oil	White Paper Highlights	Imperial Oil
Gross income	$50,000	$50,000	$50,000	$50,000
Deductions other than state tax*	2,500	6,789	1,000	6,789
State income tax	5,059	4,249	—	—
	42,441	38,962	49,000	43,211
Exemptions	2,400	2,400	2,400	2,400
Taxable income	40,041	36,562	46,600	40,811
Tax on 1st bracket	12,140	10,340	1,780	1,780
Percentage of balance	20	253	3,304	2,494
	12,160	10,593	5,084	4,274
Surcharge/(Credit)	1,216	**	(25)	(25)
Net tax	13,376	10,593	5,059	4,249
Social Security Tax***	374	374		
State income tax	5,059	4,249		
Total U.S. taxes	18,809	15,216		
Canadian tax per White Paper†		20,192		
U.S. Tax under Canadian		4,976		
Overestimate of U.S. taxes by White Paper ($18,909–15,216)		3,593		

*See notes behind Table 8.
**Surcharge has been omitted from Imperial Oil calculations since it expires on June 30, 1970.
***Maximum.
†1975 rate used, i.e., after full White Paper proposals have been implemented.

TABLE 8

COMPARISON OF U.S. FEDERAL INCOME TAXES
AT VARIOUS SALARY LEVELS WITH CANADIAN INCOME TAXES
WHERE U.S. TAXPAYER IS NOT SUBJECT TO STATE INCOME TAX, E.G. OHIO

(Taxpayer is married with two dependant children under 16)
(Rates anticipated for 1971)

Gross income	$5,000	$10,000	$20,000	$50,000
Itemized deductions*	1,147	1,895	3,293	6,789
Exemptions	2,400	2,400	2,400	2,400
	3,547	4,295	5,693	9,189
Taxable income	1,453	5,705	14,307	40,811
Tax on 1st bracker	140	620	2,260	12,140
Percentage of balance	68	324	577	389
Total federal income tax	208	944	2,837	12,529
Social Security Tax	240**	374***	374***	374***
Total U.S. tax burden	448	1,318	3,211	12,903
Canadian tax per White Paper	425	1,913	5,620	20,192†
U.S. tax over/(under) Canadian	23	(595)	(2,409)	(7,289)

*See notes behind Table 8.
**4.8% × $5,000.
***Maximum.
†1975 rate used, i.e., after full White Paper proposals have been implemented.

NOTES TO TABLES 4-8 INCLUSIVE

We believe that the comparison of taxes on personal income in Canada and the United States as shown in the "White Paper Highlights" was grossly misleading. For example, let us compare the "Highlights" Table with our Tables 4, 5, 6, 7 and 8 for married taxpayers with two dependant children under 16 years of age. We have selected income levels of $5,000, $10,000, $20,000 and $50,000, respectively. It can quickly be observed that our calculations of U.S. tax are considerably below those of the "White Paper Highlights" and, except in one instance, are lower than Canadian tax. The main reasons for this difference are:—

(a) The itemized deductions used by us are significantly higher, but much more appropriate, than those used in the "White Paper Highlights".

(b) We omitted the federal surcharge of 10 per cent which has already been reduced to 5 per cent and is scheduled to be repealed by June 30, 1970.

We believe that our method of determining the itemized deductions provides a more accurate picture of a U.S. individual's tax burden. Our method is supported by information in the Internal Revenue Service "Statistics of Income 1966". The Tables contained therein do not detail the number of returns filed where the itemized deductions amounted to exactly 5 per cent of adjusted gross income, so we analyzed the data with respect to returns where such deductions amounted to less than 10 per cent of adjusted gross income. Our review indicated that only about 10 per cent of the returns showing adjusted gross income of $10,000 or more fell into this category. Further, in only about 4 per cent of the returns showing itemized deductions did such deductions amount to less than 10 per cent of adjusted gross. Therefore, in view of the conservative approach taken it can be seen that the 5 per cent plus state income tax method used by the "White Paper Highlights" is unreasonable. In addition, such an approach means that the itemized deductions of a person with an adjusted gross of up to $20,000 is limited to $1,000 (equivalent to the standard deduction) plus state income taxes. This would not appear to be realistic in light of the facts shown above.

Although the "White Paper Highlights" have recognized the fact that the higher the

income the more likely a taxpayer is to itemize deductions, we feel it has set the starting point too high. In 1966, for example, something like 67 per cent of the returns reporting adjusted gross income of over $5,000 itemized deductions. Further, of those returns itemizing deductions, about 80 per cent reported adjusted gross income in excess of $5,000. For this reason, we consistently followed our method even at the lowest level shown in our Tables.

A further major change made by the U.S. Tax Reform Bill of 1969, which would affect our calculations, is the increase in the personal exemption over a period of four years to $750.00 from $600.00. This tax reduction is not reflected in our Tables.

TABLE 9

SAMPLE COMPUTATIONS OF THE QUINQUENNIAL TAX AND A TAX ON A REALIZED CAPITAL GAIN

Suppose and unskilled investor is faced with two purchases and one sale of the shares of a company as well as two quinquennial revaluations over a six-year period, viz:

1. Purchase 100 shares at $25.
2. First quinquennial tax calculation when shares are worth $20 shows a deductible loss of $250.
3. Purchase 50 more shares at $14.
4. Sell 60 shares at $21 and realize a taxable gain of $90.
5. Second quinquennial tax calculation when shares are at $19 shows a taxable gain of $45.

The calculations below show how the final taxable gain is computed at a time when the remaining shares are worth less than cost or previous quinquennial value and the cheapest shares have been sold.

We doubt if many uninitiated taxpayers or income tax assessors will find this an easy exercise. Not everyone has access to a computer!

			Number of Shares	Dollars	Taxable Profit or Deductible (Loss)
1. Purchase 100 shares at		$25	100	2,500	
2. First quinquennial revaluation the value per share is		$20	100	2,000	(250) loss
3. Purchase 50 more shares at		$14	50	700	
			150	2,700	
4. Sell 60 shares at Cost of sold shares could be considered to be $25, $20, $14 or $18		$21			
Average value of sold shares is ($2,700 ÷ 150)		$18	(60)	(1,080)	
Computation of taxable profit on sale:— Proceeds 60 shares × $21	$1,260				
Average value	1,080				
Gain	180				
Taxable gain (½)	90				90 profit
Remaining shares at average value of		$18	90	1,620	
5. Second quinquennial revaluation the value per share is		$19	90	1,710	45 profit

TABLE 10

A COMPARISON OF THE INCOME TAXES PAYABLE ON A DIVIDEND OF $100 UNDER THE PRESENT SYSTEM AND UNDER THE PROPOSED SEMI-INTEGRATION SYSTEM WITH VARYING AMOUNTS OF CREDITABLE TAX

Present range of taxable incomes	4—6,000	6—8,000	8—10,000	10—12,000	12—15,000	15—25,000	25—40,000	40—60,000	60—90,000
Proposed range of taxable incomes	4—5,000	5—7,000	7—10,000	10—13,000	13—16,000	16—24,000	24—35,000	35—55,000	55—85,000
Present system									
Marginal tax rate	28.66%	26.78%	30.90%	36.05%	41.20%	46.35%	46.35%	56.65%	61.80%
Taxes actually payable	$8.06	$6.18	$10.30	$15.45	$20.60	$25.75	$30.90	$36.05	$41.20
Taxes Payable under Proposed System									
Amount of creditable tax as a percentage of the dividend:								*****	*****
50%	$(3.92)*	$(.08)*	$ 3.76	$ 7.60	$13.36	$19.12	$26.80	$34.80	$42.16
40%	3.01	6.59	10.16	13.76	19.14	24.51	31.68	38.84	46.02
30%	9.93	13.26	16.58	19.92	24.91	29.90	36.56	43.21	49.87
20%	16.86	19.94	23.00	26.08	30.69	35.29	41.44	47.58	53.73
10%	23.79	26.61	29.42	32.24	36.46	40.69	46.32	51.95	57.58
zero	30.72	33.28	35.84	38.40	42.24	46.08	51.20	56.32	61.44
Amount of creditable tax which equates the tax under the new system with that under the present	32.7%	40.6%	39.8%	37.3%	37.5%	37.7%	41.6%	46.4%	50+%
Maximum gain from the proposed system expressed as a % of present system after-tax income	13.1%	6.7%	7.3%	9.3%	9.1%	8.9%	5.9%	2.5%	Loss

NOTE: If the dividends qualify for shareholder depletion under the present system the present tax is lower and the breakeven point on the new system is higher.
*Negative tax or refund.
*****If the White Paper proposals are fully implemented, these amounts of tax will be replaced by those in the column immediately to the left thereof under the heading 25—40,000.

TABLE 11

A COMPARISON OF THE TAXES PAYABLE ON VARIOUS INCOMES CONSISTING SOLELY OF DIVIDENDS WITH THE FULL AMOUNT OF CREDITABLE TAX

Income	Present Situation	White Paper Proposals	Decrease in Taxes under the White Paper
	Single—No Dependants		
$10,000.00	$360.00	$(564.80)*	$924.80
13,456.07	664.85	—	664.85
15,000.00	982.90	295.20	687.70
16,830.12	1,397.51	645.12	752.39
	Married—No Dependants		
$10,000.00	360.00	(1,121.60)*	1,481.60
13,456.07	360.00	(645.12)*	1,005.12
15,000.00	570.90	(349.92)*	920.82
16,830.12	947.91	—	947.91

*Indicates negative tax or a cash payment "Refund" (4.37) to the taxpayer.

TABLE 12

HOW INCOME TAX INCENTIVES GIVEN AT THE CORPORATE LEVEL ARE TAKEN AWAY FROM THE SHAREHOLDER

	Widely-Held		Closely-Held	
	No Incentive	Incentive	No Incentive	Incentive
	50% Tax	30% Tax	50% Tax	30% Tax
Corporate earnings before tax	$200	$200	$200	$200
Corporation income at 50%	100		100	
Corporation income tax as reduced by incentives		60		60
Available for and paid as a dividend	100	140	100	140
Taxable income of shareholder:				
Dividend plus—				
½ of the corporation income tax	150	170		
all of the corporation income tax			200	200
Personal income tax of shareholder at, say, 50%	75	85	100	100
Tax credit—				
½ of the corporation income tax	(50)	(30)		
all of the corporation income tax			(100)	(60)
Net tax payable by shareholder	25	55	—	40
Net after-tax income of shareholder	75	85	100	100
Increase in shareholder's income due to inventive legislation	—	10	—	Nil
Fraction of corporation income tax incentive of $40 retained by shareholder		¼		Nil

TABLE 13

AN ILLUSTRATION OF THE INTERCOMPANY OR "UPSTREAM" DIVIDEND TAX
(BASED ON PARAGRAPHS 4.58 AND 4.59)

	Present Rules	White Paper Rules
Dividend received by a widely-held holding from a widely-held operating company....	$100	$100
Plus taxable credit—assuming that pay or did not have enough, say, 2/5ths...........	—	20
Deduction under Section 28(1)(a)........	(100)	—
Taxable amount........	—	120
Gross tax at 33-1/3% (4.59)........	—	40
Less credit........	—	(20)
Net intercompany or "upstream" dividend tax........	—	20
Amount available for distribution to the shareholders of the holding company (divident minus net tax)........	100	80
Decrease in amount available for dividends or retention by the holding company.....		20

Paragraph 4.59 proposes a 33-1/3% "..... special tax rate be applied to the dividends received by Canadian public corporations from other Canadian public corporations ....." in order to avoid taxing a second time profits fully taxed in operating companies. This desirable objective (which the present system achieves with ease) could not be reached under the White Paper unless each of the provinces (whose rates presently differ) agreed to keep the sum of its tax and the federal tax at 33-1/3%.

APPENDIX "B"

Name: Imperial Oil Limited

Subject: Commentary on White Paper Proposals

Analysis of Appendix "A" by Senior Advisor

This comprehensive brief is being submitted by Imperial Oil Limited. This company is a fully integrated petroleum company whose operations extend from basic exploration through to the marketing of finished petroleum products. Its activities embrace a variety of associated interests, including the manufacture and sale of chemicals and building products, exploration for mineral resources and the sale of products in the automotive after-market.

The brief itself first submits lengthy and carefully prepared comments on the impact of the White Paper proposals on the Canadian economy. (Pages 6 to 20). It points out the inadequacies of many of the proposals and suggests alternatives.

It then deals with the following specific aspects of the White Paper proposals:

(1) The Capital Gains Tax. (Page 21 to (35).

(2) Integration of Corporation and (Individual Taxes. Pages 37 to 47).

(3) Lower rate of tax on first $35,000 of (Corporate Taxable Income. Pages 48 to 52).

(4) Tables of comparative taxes (Following Page 66).

Finally, the brief refers to:

(1) The Canadian Oil and Gas Industry. (Pages 53 to 62)

(2) The Development of the Athabasca Tar Sands and other Alberta Oil Sands. (Pages 63 to 66).

Numerous recommendations are contained in the brief, but members of the Committee will be interested in the general recommendations set out on Page 3 of the brief, which read as follows:

"As an alternative to these adverse aspects of the White Paper, we recommend that tax reform should embody:...

1. A personal rate structure which woud not significantly exceed U.S. rates.

2. The present dividend tax credit system in lieu of the proposed integration concept.

3. The present two-tier corporate income tax for small businesses.

4. A depletion allowance for the petroleum industry which would be calculated as a percentage of gross income from production at a rate at least competitive with the current United States rate, and including an appropriate limitation based on net income from production.

"Canada has a good opportunity to supply, on a competitive and economic basis, extensive and growing export markets. The significance of both crude oil and natural gas in the national economy has intensified the importance of a depletion allowance as a means of maintaining adequate secure supplies. At the present moment, the oil industry is exploring in the more remote, high-cost areas and an adequate depletion allowance tends to offset the bias against risk-taking in the capital markets. Thus, it is Imperial's judgment that the oil industry should be provided with an incentive which is at least equal to that provided in the United States, where our largest export market exists."

The usual summary of present tax laws, White Paper proposals and principal points of the brief is attached.

Name: Imperial Oil Limited

Date Brief Received:

Principal Subject: The Capital Gains Tax

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act does not levy income tax on many types of capital gains.	The White Paper proposals relating to the taxation of capital gains were reviewed on pages 8 to 20 of the special study entitled, "Discussion of Principal Points of White Paper—Part 2", submitted on February 11, 1970.	Pages 21 to 35 of Brief This portion of the brief deals in considerable detail with the proposals of the White Paper to include capital gains with other income.

Name: Imperial Oil Limited

Date Brief Received:

Principal Subject: Integration Proposals for Widely-Held Canadian Companies

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
This subject has been dealt with in Special Study No. 4 "Grossing-Up of Canadian Dividends", and is not repeated here.	See Special Study No. 4 for detailed review of White Paper proposals.	Pages 37 to 47 of Brief This portion of the brief deals with the proposals of the White Paper to integrate corporate and individual income taxes and submits that these proposals be not adopted. Note summary of views contained on Page 47 of brief.

Name: Imperial Oil Limited

Date Brief Received:

Principal Subject: Lower Rate of tax on First $35,000 of Taxable Income of Corporations

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The provisions of the present Income Tax Act relating to the lower rate of tax on the first $35,000 of taxable income of a corporation have been reviewed in Special Study No. 5 "Taxation of Small Businesses", and are not repeated here.	These proposals have been reviewed in Special Study No. 5 and are not repeated here.	Pages 48 to 50 of Brief This portion of the brief refers to the injurious effect of the White Paper proposals on small businesses.

Name: Imperial Oil Limited

Date Brief Received:

Principal Subject: Capital Cost Allowances on Buildings

Present Tax Law

At the present time taxpayers are permitted to claim capital cost allowances as a deduction from revenues from buildings and other depreciable assets owned by them.

Any excess of capital cost allowances claimed over revenues can be deducted from other income of the taxpayer.

Tax Reform Proposals

5.16 Many taxpayers who would otherwise be in quite high tax brackets have become landlords, and have been able to reduce or eliminate the tax on their other income by claiming the maximum depreciation on their buildings. Ideally this early generosity should be offset by lower depreciation deductions in later years, or by recapture of the extra depreciation on sale. However, if the taxpayer buys additional buildings—and with the relatively low down payments required, this can often be done out of the tax savings alone—he can postpone almost indefinitely the day when his total depreciation deductions will drop below average. Moreover, since most of the buildings concerned are in the same class, a taxpayer who sells a building can avoid recapture of the proceeds by investing them in another building. Finally, if the taxpayer continues this process throughout his life, the tax postponed becomes tax saved forever. When a taxpayer dies, excess depreciation is not recaptured, and the person who inherits the buildings is entitled to depreciate the full fair market value of the buildings, no matter what net book value his predecessor had.

5.17 The government proposes to close this loophole in three ways. First, as mentioned in Chapter 3, a person who inherits property would for tax purposes inherit the tax cost of that property to the deceased. In this case, that would mean that the inheritor starts with the same base for depreciation as the deceased had when he died. Second, a taxpayer would be prohibited from deducting

Principal Points of Brief

Pages 51 and 52 of Brief

This portion of the brief sets out the company's views of the results if the White Paper proposals are adopted.

from other income a loss from holding property if that loss is created by capital cost allowance. (It is also proposed that the same restriction be placed on the deductibility of losses arising from holding property if those losses are created by a deduction of interest or property taxes. Otherwise taxpayers could reduce or eliminate the tax on their current incomes by holding large amounts of speculative property.) Finally, it is proposed that a separate depreciation class be created for each rental building that costs $50,000 or more. This would mean that there would be a day of reckoning for the owner of each large building. As each such building is sold the taxpayer would bring back into income the amount by which depreciation deducted for tax purposes exceeds the depreciation actually suffered, or conversely he would get a deduction for tax purposes immediately if he has in fact suffered greater depreciation than he has been allowed for tax purposes.

5.18 Because the depreciation rates are based on averages, they sometimes turn out to be inadequate. Indeed, as the royal commission pointed out, there are instances in which the net book value of a class of assets becomes greater than the cost of the assets that the taxpayer has on hand at the time. This arises, of course, because the depreciation he has been permitted was not as great as the actual depreciation suffered on some of the assets which he has since sold or scrapped. This problem would disappear in the case of rental buildings which cost more than $50,000 as explained in the previous paragraph. However, it would remain for other assets. Consequently the government proposes that taxpayers be permitted at any time to write a class of assets down to the aggregate cost of the assets of that type still on hand.

Name: Imperial Oil Limited

Date Brief Received:

Principal Subject: Capital Cost Allowances on Buildings (Continued)

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	5.19 The government also proposes to require corporations to make this type of write-down in any year in which control of the corporation changes hands. This proposal will help to restrict the sale of business losses.	
	3.54 Another example concerns taxpayers who own depreciable property that they are using for income-earning purposes. Consider the case of a taxpayer who bought an apartment building for $500,000 and has over the years claimed depreciation for tax purposes of $200,000. Under the present system if he sells the apartment building for more than $300,000, the next $200,000 is treated as a "recapture" of the depreciation he has been permitted and either directly or indirectly comes into the computation of his taxable income. Only if he sells the building for more than $500,000 will any part of the proceeds be considered a capital gain—the excess over $500,000. The act would be drawn up in such a way as to make it clear that the taxpayer is still liable for tax on recaptured depreciation.	
	4.79 To secure tax on the recapturable depreciation, it is proposed that part of the tax paid by closely-held corporations be treated as non-creditable until non-creditable tax has been collected on the amount that would have been taxable under the present system. This would of course not accomplish the objective with respect to corporations that are to be treated as partnerships. Shareholders of such corporations would have to elect to	

value their shares in the same manner as a proprietor or partner is to value his business assets —at values that would leave inventory profits and recapturable depreciation taxable.

Name: Imperial Oil Limited

Date Brief Received:

Principal Subject: The Canadian Oil and Gas Industry—Depletion Allowed to Operators

Present Tax Law

Section 11-1-b of the Income Tax Act and Part XII, Section 1201 of the Income Tax Regulations

These sections permit the operator of an oil or gas well to deduct a depletion allowance of $33\frac{1}{3}\%$ of the balance of production income remaining after the deducting therefrom lifting costs, capital cost allowances claimed in the year and 83A credits claimed in the year.

Tax Reform Proposals

The White Paper proposals respecting depletion are set out in the following paragraphs:

1.52 The second change concerns depletion allowances. The existing maximums would continue to apply—generally no more than one-third of production profits—but a taxpayer could run out of depletion allowances unless he continues to explore for and/or develop, Canadian minerals. Every $3 of qualifying expenditures made after this White Paper is published would "earn" the taxpayer the right to $1 of depletion allowances if and when his production profits permit. Depletion allowances on new properties would have to be "earned depletion" immediately: "unearned" allowances would be continued for five years on existing properties as a transitional measure. This proposal is more fully explained in Chapter 5. That chapter also sets out other changes of detail applying to the mineral industry. They flow mainly from other more general changes proposed in the tax system.

5.36 At present, the act provides that operators of mineral resources, and this phrase includes oil and gas wells, are entitled to reduce their taxable income by claiming depletion allowances. For the most part of these depletion allowances are calculated as a percentage of the profits derived from production from the mineral resource, and the usual percentage is $33\frac{1}{3}$ per cent. Special rates of depletion are provided for gold and for coal.

Principal Points of Brief

Pages 53 to 62 of Brief

This portion of the brief deals in considerable detail with the White Paper proposal to limit the present percentage depletion to a so-called "earned depletion."

Page 53 of the brief recommends that depletion be allowed as a percentage of gross production income limited to an appropriate percentage of net production income.

Pages 63 to 66 of Brief

This portion of the brief relates to the development of Athabasca and other Alberta viscous oil sands and endorses the submissions made by Syncrude Canada Limited.

Page 66 recommends that allowance of depletion calculated as a percentage of gross income at rates comparable to those used in the United States, without the limitation proposed in Paragraph 5.40 of the White Paper.

5.37 Originally, these allowances were intended to recognize that an ore body or a pool of oil was of a limited size, and that part of the proceeds of the sale of the mineral was a return of the capital investment in the resource. In those days many of the costs of acquiring and developing mineral rights were not deductible for tax purposes and depletion allowances made up for this fact. However, over the years more and more of the costs have become deductible, until under these proposals all such costs would be deductible. Depletion allowances would no longer be needed for the accurate measurement of income from a mine or field: they would be transformed into an incentive designed to induce taxpayers to undertake more exploration and development than they otherwise would. Other countries, and most notably the United States, have similar incentives in their law.

5.38 As mentioned earlier, the government has concluded that the tax system should continue to contain in incentive of this nature. However, it believes that the present incentive is inefficient in two respects. First depletion applies to all production profits regardless of the exploration effort of the taxpayer. It is only indirectly related to the activity it seeks to encourage. If a taxpayer stumbles on a mine, he would, under present rules, be entitled to a depletion allowances against the profits from that mine for all time to come, even if he never spends another cent exploring for minerals.

5.39 A second inefficiency is also related to the fact that the depletion allowance applies to all production profits without limit. Because exploration and development costs must be deducted in computing production profits for this purpose, the operator of a mineral resource can logically claim he is inhibited from engaging in exploration by the rules concerning depletion. The exploration

Name: Imperial Oil Limited

Date Brief Received:

Principal Subject: The Canadian Oil and Gas Industry—Depletion Allowed to Operators

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	costs reduce the depletion allowance: therefore it can be argued that the provision designed to increase exploration can in some cases reduce it.	
	5.40 The government believes that both of these inefficiencies can be subtantially reduced if depletion allowances are more directly related to the activities which it is desired to affect. Consequently it is proposed that, after a suitable transitional period in respect of mineral rights held by the taxpayer on the day this White Paper is published, depletion allowances would have to be "earned". The existing maximums would continue to apply—that is, generally no more than 1/3 of production profits—but a taxpayer could only deduct these maximums, or any amount, if he spends enough on exploration for or development of mineral deposits in Canada or on those fixed assets described in paragraph 5.29 that are acquired for the exploitation of a new Canadian mine. The formula proposed is that for every $3 of eligible expenditures made after this White Paper is published a taxpayer would earn the right to $1 of depletion allowance. If his profits that year are not sufficient to permit him to deduct the amount earned, he could carry the undeducted amount over to subsequent years. The cost of acquiring mineral rights would not be an eligible expenditure for this purpose.	
	5.41 Under the proposed system, a taxpayer could run out of depletion allowances unless he continues to explore for, and/or develop, Canadian minerals. Once the system is fully effective, a	

taxpayer's allowances would end when his profits before "eligible expenditures" exceed twice the amount of those expenditures. Consider the following example:

Profits before eligible expenditures	$6,003
Deduct eligible expenditures	3,000
	3,003
Maximnm depletion $1,001 (1/3 of $3,003	
Earned depletion (1/3 of $3,000)	1,000
Taxable income	$2,003

5.42 The system would not become fully effective immediately. The government proposes that for the first five years of the new system taxpayers be entitled to depletion allowances in respect of production profits from properties they now own without having to "earn" them. This period, combined with the entitlements to the earned allowances that taxpayers would be able to accumulate between the publication of this White Paper and the end of 1975, should enable the mineral industries to make a smooth transition to the new system.

Name: Imperial Oil Limited

Date Brief Received:

Principal Subject: The Canadian Oil and Gas Industry—Depletion Allowed on Royalties

Present Tax Law

Section 11-1-b of the Income Tax Act and Part XII, Section 1202 of the Income Tax Regulations

These sections permit a person who receives a royalty computed on the value of the production of an oil or gas well to deduct 25% of the amount received.

Tax Reform Proposals

The White Paper proposals relating to depletion allowances granted non-operators are set out in the following paragraph:

5.43 Under the present legislation a depletion allowance of 25 per cent may be deducted by non-operators from their income from mineral properties. This provision applies principally to the holders of royalties. The concession sought to recognize that royalties might well in part be a return of capital. This fact would under the present proposals be more accurately recognized by the proposed rules concerning the amortization of the cost of acquiring mineral rights. Therefore it is proposed that the percentage depletion at present available to non-operators be repealed.

Principal Points of Brief

Page 62 of Brief

This portion of the brief states that the White Paper proposal to eliminate the present 25% allowance on oil and gas royalties is unfair.

Name: Imperial Oil Limited

Date Brief Received:

Principal Subject: Tables of Tax Calculations

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		List of Tables following Page 66 of Brief
		This portion of the brief furnishes useful comparisons of the monetary impact of the White Paper proposals.
		Page 36 of Brief
		This portion of the brief refers to comparable corporation tax rates in Canada and in the United States.

APPENDIX "C"

Elgistan Management Limited
and
Associated Companies

Submission to

The Standing Senate Committee
on Banking, Trade and Commerce

on

THE WHITE PAPER PROPOSALS FOR TAX REFORM

March, 1970

INDEX

I. SUMMARY

(1) This submission is made by Elgistan Management Limited ("the Company") on behalf of a number of non-resident investors ("the Owners") who, over a period of forty years, have followed a consistent policy of long-term investment for the security of capital and for the growth that was expected in Canada. The total value of the assets managed in Canada exceeds $100 million of which approximately 70 per cent is invested in Canada. We believe that the investment policy followed has made, and is still making, a significant contribution to the development of Canada.

(2) The effects of the White Paper proposals appear to be such that they would curtail formation of capital in Canada and, at the same time, place obstacles in the way of the free flow of capital both in and out of Canada. Such effects would run counter to the best interests of both the Canadian economy and the world economy.

(3) The following White Paper proposals would contribute to creating an inhospitable climate for foreign investment in Canadian portfolio securities and in other investments in Canada of a desirable nature from Canada's point of view:

(a) The taxation of capital gains as income

(b) The taxation of non-residents on gains from sale of shares of certain Canadian corporations (all Closely-held Canadian Corporations ("CHCs") and those Widely-held Canadian Corporations ("WHCs") in which 25 per cent or more is held).

(c) Quinquennial revaluation of shares of WHC's.

(4) There is insufficient detail in the White Paper to be able to determine the government's intentions with respect to the taxation of income and gains derived from the investment of foreign capital in Canada through the medium of non-resident owned Canadian resident entities and this uncertainty is already causing loss of confidence by foreigners in investment in Canada. In this particular case it is not possible to assess the implications of the proposed tax reform upon:

(a) The taxation of Non-Resident-Owned Investment Corporations ("NROICs")

(b) The taxation of a non-resident owned private open-end unit trust

(c) The taxation of a Canadian trust for non-resident beneficiairies.

(5) Nevertheless, a study of the White Paper directed specifically to the circumstances of this particular case raises serious questions with respect to the intentions of the government. In Appendices B & C attached to this submission, certain assumptions with respect to these intentions have been made. Should the consequences of the proposed tax reform prove to resemble remotely those depicted in the appendices, little alternative would remain but to withdraw the capital funds from Canada.

(6) The recommendations made in this submission can be summarized as follows:

(a) That there be equity of taxation between non-residents who invest directy in Canada and those who, for good business reasons, invest through the medium of wholly owned Canadian entities, such as corporations and trusts (for suggestions as to how this could be achieved, see Section VI, Recommendations).

(b) That the effective rate of capital gains tax suffered by non-residents on real property, partnership interests and branch assets not exceed the maximum rate applicable to residents of Canada.

(c) That the proposal whereby non-residents would be taxable on gains on disposal of shares of CHC's and of shares of WHC's in which 25 per cent or more is held be withdrawn.

(d) That the proposal calling for a quinquennial revaluation of shares of WHC's be withdrawn.

II. INTRODUCTION

This submission is made by the Company on behalf of the Owners; these include non-resident individuals and trusts, and a Canadian trust, the beneficiaries of which are all non-residents. Almost all of the Owners are residents either of the United Kingdom or of the Republic of Ireland. The Company provides the necessary management and administration for substantial funds ("Elgistan Funds") which, over a period of years, have been invested by the Owners and retained in Canada. The investments of Elgistan Funds are varied, but a broad division into two main categories can be made:

(1) Investment in marketable or portfolio securities most of which, for ease of management, have been collected in a private unit trust fund (an entity similar in structure, but not in ownership, to the more widely known public "open-end" or mutual fund),

(2) Investment in non-marketable or direct ventures in the development and ownership of large office buildings in Western Canada, and in business engaged in merchandising construction equipment and building supplies, ranching, marketing and transportation of oil and toy manufacturing. Venture capital has also been provided to the cement industry.

The manner in which the investments of Elgistan Funds are held is given in Appendix A in abbreviated chart form. Generally speaking, each Owner's interests are held through a special type of private company known as an NROIC which is accorded special treatment under the Income Tax Act. The Company manages a number of such corporations, all of which participate directly or indirectly in the unit trust fund referred to above, and in the direct ventures to a greater or lesser extent. The direct ventures themselves are usually, but not invariably, conducted through private companies, taxed under the laws applicable to ordinary taxpaying corporations, which would be classed as CHC's under the White Paper proposals. Where control of these companies is held by the Owners, the Company furnishes management services to them. The estimated value of the assets employed in direct ventures and the market value of the portfolio securities amount to a sum exceeding $100 million, of which approximately 70 per cent is invested in Canada.

It is worth nothing that investment in Canadian securities and enterprises has continued without interruption for over forty years. Money has not been withdrawn from the country when it appeared to most informed observers that Canada was about to experience poor economic conditions; instead, the funds were retained on a long-term basis in the country, and these suffered as much from any economic slow-down as the funds of resident Canadians. In short, a long-term view has always been taken of Canada's prospects and future prosperity, and funds have not been moved in and out at the dictate of short-term market conditions.

This policy has proved to be a successful one, and it has enabled the Company to develop and maintain an organization staffed almost entirely by Canadians. Apart from the Company's management staff, many other job opportunities have been provided to Cana-

dians, and the current payroll of companies managed by the Company includes some 170 persons in regular employment. Clearly a great many more Canadians have benefited from the impact of large direct capital investments undertaken by the Owners over the years. For example, the impact on the local economy of the construction of a large office building is far greater than the capital employed to create such a building.

The Owners have assumed risks in direct ventures, which Canadian investors were not prepared to take at certain times in the past either because the degree of risk was too great or because they have insufficient venture capital at their disposal. On some of these investments, losses were sustained and, in some cases, the return on invested capital did not meet expectations; in general, however, the investment experience of the Owners has been a favourable one, and their confidence in Canada's potential has been rewarded. It is submitted that the povision of both risk and portfolio capital has been of advantage to Canada as well as to the Owners.

Canada attracted this investment interest because it provided a combination of political stability, reasonable tax laws and opportunities for growth which at least matched opportunities available elsewhere; but the decision whether to invest in Canada or in other countries has been considerably influenced by the hospitable tax climate in Canada. If Canada's tax system were to become uncompetitive with other countries, it would be natural for the Owners to reassess their position in Canada.

III. SOME ECONOMIC IMPLICATIONS OF THE PROPOSALS

It is not too much to say that through direct overseas investment a new World economy is now taking shape. The scale and the diversity of this global movement is not easy to indicate in any simple way. The total of World private direct foreign investment is now in the neighbourhood of $100 billion; and, although the figures can only be of a rough order of magnitude, this total has been steadily expanding. While the United States is playing the leading role in these great changes, it is true that most other important industrial countries are investing abroad on an increasing scale. It is evident that we are passing through a new and remarkable process of international economic integration, which carries with it the possibility of economic benefits for richer and poorer countries alike. Any country whichstands aside from or seriously blocks these global movements is only too likely to wound itself, or damage other countries, or do both.

No country in the world in the last forty years has benefited more than Canada from the fertilizing flow of capital from other countries. This, however, has not been a one-way traffic. Canada herself has exported capital in considerable quantities to the United States, Australia, the United Kingdom and other countries to the benefit of all parties.

Canada's underdeveloped resources are immense and her ability to develop them as rapidly as possible, and at the same time rationally, depends, in large measure, upon availability of capital. No one can deny that Canada herself should provide as much of the capital required as possible and, therefore, that the Canadian taxation system should be designed to encourage domestic savings.

In Canada's interests we question seriously the desirability of the imposition of a capital gains tax. The taxation of gains would curtail domestic savings available for investment and would also tend to discourage investments in ventures carrying a high degree of risk, so necessary to the development of Canada's natural resources. Furthermore, the treatment of capital gains as income could not fail, in our view, to tend to remove from the minds of Canadians the long established distinction between capital and income and thus would encourage dissipation of domestic savings.

However, Canada's needs are far too great to be satisfied by her own resources of capital and she must look to capital inflows from abroad. The taxation system, therefore, should be such as to maintain an hospitable climate for foreign investment. Not only is this desirable in the context of Canada's development, but it is also important from the point of view of the growth of the world economy, upon which the future prosperity of Canada and all other nations hinges, that impediments to the free flow of capital between nations be kept to a minimum.

Despite assertions in the White Paper to the contrary, one cannot help but detect in the tenor of its proposals a tendency towards placing obstacles in the way of free flow of capital in and out of Canada.

Under the proposals, income and gains from investments made by Canadians in foreign portfolio securities would be much

more heavily taxed than would income and gains from WHC's. This would undoubtedly artificially restrict free outflow of Canadian capital.

The White Paper (8.47) states that "Non-resident investors in Canada should not be substantially affected by the tax changes proposed in this paper except in particular categories" and goes on to say that "On the whole these changes affecting non-residents are not expected to cause any substantial reduction in foreign investment in Canada, although some decline must be expected in foreign investment in the mineral industries and in small closely-held corporations". We believe this to be an understatement of the effect the proposals would have upon the inflow of capital.

The high rate of the proposed capital gains tax would undoubtedly prove to be a deterrent to the inflow of foreign capital and, in addition, could well bring about an outflow of foreign capital. Furthermore, the integration proposals, coupled with the Canadian withholding tax, which would result in non-resident investors paying taxes on income and capital gains at rates higher than the maximum rates payable by Canadians (quite the reverse of the present situation whereby foreign investors are taxed at the withholding rate of 15 per cent and Canadians at personal rates with dividend credit where appropriate), could not fail to have some adverse effect upon the inflow of foreign capital. The foregoing factors could have serious repercussions on Canadian balance of payments.

From time to time, foreign take-over of Canadian industry and resources may have been called into question, but there can be no question of the desirability of maintaining an hospitable tax climate for foreign investment in Canadian portfolio investments and in new ventures designed to hasten the development of Canada—in fact the very purposes to which Elgistan Funds have been put over the past 40 years.

IV. TAXATION OF FOREIGN CAPITAL

Certain of the proposals made in the White Paper with respect to the taxation of income and gains on foreign capital are sufficiently precise for an opinion to be formed as to the effect they may be expected to have upon the inflow of new foreign capital and upon the retention of foreign capital already in Canada. There are, however, many areas where the White Paper is far from explicit and it is not possible to determine at all what impact the contemplated tax reform would have upon foreign capital in general and upon Elgistan Funds in particular.

In this section of our submission we attempt to delineate the areas of certainty and those of uncertainty and to comment upon them.

(1) Areas of certainty

As we see it there are three areas in the proposals which, if implemented, could not help but create an inhospitable climate for foreign capital, namely:

(a) The taxation of capital gains as income,

(b) The taxation of non-residents on gains from sale of certain shares in Canadian corporations (all CHC's and those WHC's in which 25 per cent or more is held),

(c) Quinquennial revaluation of shares of WHC's.

(a) The taxation of capital gains as income

Under the proposals all capital gains are to be treated as income and, with the exception of gains on disposal of shares in WHC's, are to be taxed at the full rates applicable to income. The integration proposals tend to soften the overall impact of the corporate and personal taxes for Canadian shareholders, but not for foreign shareholders to whom it is not proposed to pass on creditable tax (4.49). Take, for example, the U.K. resident who, through a wholly-owned Canadian corporation, develops and operates commercial buildings in Canada. It could be expected that at some future date one or all of the buildings might be sold at a profit. A gain so made would be subject to tax at 50 per cent and it seems that, when the net gain is distributed to the U.K. shareholder, it would be taxable as income at a minimum withholding tax rate of 15 per cent, without relief for creditable tax, resulting in overall Canadian taxes of 57.5 per cent. Even assuming full relief from U.K. capital gains tax of 30 per cent upon distribution of the gain, he would have suffered a total capital gains tax (all Canadian) of at least 57.5 per cent which, in our opinion, is sufficiently confiscatory in comparison with other jurisdictions to weigh heavily against a decision to make such an investment in Canada.

(b) The taxation of non-residents on gains from sale of shares in certain Canadian corporations (all CHC's and WHC's in which 25 per cent or more is held)

To the best of our knowledge legislation along the lines of this proposal is only to be found in one of the developed countries, West Germany, and its implementation in Canada, in our opinion, could have serious international consequences. Furthermore, it would appear to violate present tax treaties at least with the U.S., the U.K., Sweden and Finland.

The object of the proposal seems principally to close a possible loop-hole enabling non-residents to realize indirectly a tax-free capital gain on property (such as real estate and business property) which, if disposed of directly, would have been taxable. If loophole there is, it is urged strongly that a far less all-embracing method of closing it be found than that contained in the proposals.

(c) Quinquennial revaluation of shares of WHC's

The White Paper (3.33) proposes that taxpayers, other than WHC's, revalue their shares in WHC's to market value every five years. This is a radical proposal that, to the best of our knowledge, has not been adopted in any other major country. It amounts to taxing, as gains, amounts which to the taxpayer are not gains and may never become gains, and might be properly described as a "wealth tax".

Stock market levels are frequently subject to wide fluctuations in a short period of time with the result that, if a taxpayer's revaluation date fell within a relatively short period of abnormally high stock market levels, he, short of selling some of his investments as soon as levels dropped, would be in the position of having made a tax-free loan to the government for as long as five years. In stocks of a cyclical or volatile nature, this sort of situation could become considerably more aggravated. This proposal could also cause serious and inequitable problems for a major shareholder, forcing him, perhaps, to relinquish effective control of the company. Equally serious could be the situation of a shareholder whose shares were held in escrow or subject to a voting trust agreement. The White Paper (3.37) assets that the periodic revaluation would reduce the lock-in effect and, hence, would reduce what might otherwise be an obstacle to the workings of the capital market. It could equally validly be argued that the revaluation feature, by forcing realization, would prove to be an added obstacle to the workings of the capital market. The introduction of any capital gains tax is bound to bring with it an unnatural influence on sound investment policy and the proposed revaluation appears to intensify this influence.

We are of the opinion that this proposal, if implemented, would be injurious to the development of Canada both by domestic capital and by foreign capital and we urge that it be withdrawn.

(2) Areas of uncertainty

The points raised under this caption have been brought to our attention as a result of endeavouring to measure the effects which implementation of the White Paper proposals would have upon the impact of Canadian taxation upon Elgistan Funds as it is now organized and managed. Due to lack of sufficient detail in the White Paper, this could only be done on the basis of making certain assumptions; but it did become abundantly clear that, if the proposals were interpreted in certain ways, the effects would be sufficiently severe to call into question the wisdom of continuing the present policy of investment in Canada.

The points we raise in this section are as follows:

(a) Taxation of NROIC's—

(i) Incidence of tax

(ii) Rate of tax

(iii) Foreign investments

(b) Taxation of non-resident owned private open-end unit trust.

(c) Taxation of trust for non-resident beneficiaries.

(a) Taxation of NROIC's

(i) Incidence of Tax

In the short paragraph (6.40) devoted to NROIC's in the White Paper it is stated that they, "while resident in Canada, are generally treated for tax purposes as non-resident persons". One might be justified in concluding from the above quotation that it is not proposed to change the basic tax treatment of NROIC's. However, in the absence of a specific statement to this effect, there remains doubt as to the government's intentions. This is a matter of vital importance to Elgistan Funds and also, without doubt, to many other foreign investors.

Since, with two exceptions upon which we have commented earlier, it is not proposed to tax non-residents on capital gains on portfolio investments, such gains in NROIC's, if treated as non-resident persons, would also be

exempt. It is only equitable that they should be so treated. It should be fully appreciated at this point that the sources of income of a corporation, in order to be able to elect to be taxed as an NROIC, are prescribed by statute in such manner that they preclude it from holding partnership interests and branch assets and restrict holdings of real property, gains from all of which, when held directly by non-residents, it is proposed to tax (6.43).

When, as is the case with Elgistan Funds, a number of foreign investors have joined together in order to provide unified and competent management of their combined resources available for investment in Canada, the logical, and virtually the only, way to do so efficiently is to set up a Canadian organization incorporated under Canadian laws. This, however, should not in any way whatsoever alter their tax status as non-residents investing in Canada. The White Paper (6.40) appears to recognize this fact by stating that NROIC's "constitute a convenient holding device for foreign investors in Canadian securities".

(ii) Rate of Tax

The White Paper (6.40) goes on to say "The tax on such companies (NROIC's) would be increased to match the rate of the non-resident withholding tax". Earlier (6.36) it is proposed to increase the Canadian rate of withholding tax from 15 per to 25 per cent, and in 6.37 it is stated that Canada would be prepared to conclude tax treaties with most other countries providing for a 15 per cent rate on dividends. Here again, the intent is far from clear. When the White Paper speaks of a tax rate on NROIC's to match the rate of the non-resident withholding tax, does it refer to the 25 per cent or to the 15 per cent rate when the beneficial owners of an NROIC are residents of a country, the tax treaty with which provides for that rate? This point too is of considerable moment to Elgistan Funds.

In equity there can only be one answer to this question. If an NROIC is to be treated for tax purposes as a non-resident person and if the tax treatment of a non-resident person is dependent upon his country of residence, it follows that the tax treatment of an NROIC should also be dependent upon the country of residence of the beneficial owner of its shares.

In the Carter Report the point was made that NROIC's provide a vehicle whereby avoidance or deferment of tax properly payable to a foreign country is achieved. We have no knowledge that NROIC's have been used in this role and, insofar as Elgistan Funds is concerned, we state categorically that at no time has the NROIC been used as a device for avoiding taxation in foreign countries. The White Paper, by proposing an increase in the rate of withholding tax from 15 per cent to 25 per cent in those cases where a tax treaty providing for the former rate has not been negotiated, seems to us to have opened the door to removing the stigma that the Carter Commission seems to have felt clouded the NROIC. If the rate of tax applicable to each NROIC were fixed at the rate of withholding tax applicable to residents of the country of residence of the beneficial owners of the shares of the NROIC, any argument that it could be used as a device to funnel foreign income through to, for example, a resident of a tax haven country at a privileged rate of tax would be without merit.

(iii) Foreign investments

The investments of many NROIC's, we believe, include some investments in countries other than Canada, and this is certainly so in the case of Elgistan Funds. Income from these investments is normally received after deduction of foreign withholding tax. At present, in determining taxes payable, NROIC's are not allowed to claim a tax credit for the foreign tax, but they are permitted to deduct that tax in determining taxable income. The net amount received, therefore, is taxed in Canada at 15 per cent. We commented earlier upon the undesirability of the proposed taxation of income and gains from foreign investments held by Canadian residents. Insofar as non-residents are concerned, a more severe tax than at present on income of NROIC's derived from investments abroad or any attempt to tax capital gains on those investments would undoubtedly result in their being removed from Canada with a resulting loss of revenue to the Canadian government.

(b) Taxation of non-resident owned private open-end unit trust

For good business reasons, such as facility of management and coordination of investment policy, and not for any tax advantage, the vast majority of the portfolio investments administered by Elgistan Funds are held by a private open-end unit trust in which Canadian corporations, all wholly owned by non-resident beneficial owners, hold units (see Appendix A). The investments of the trust include shares of may WHC's, shares of foreign corporations and Canadian and foreign bonds. The trust income, since all of it

is distributed to the unit holders, is taxed in the hands of the NROIC's owning the units.

How the government proposes to tax an organization of this type is far from clear. In equity, since the trust is beneficially owned by non-residents, the tax borne on its income and the treatment accorded to capital gains should be the same as it would be if the underlying investments were owned directly by non-residents. At 5.56 it is proposed that a trust be treated as a corporation if it has issued transferable or redeemable units, which is so in the case under discussion. It is also proposed that, if the number of unit holders and marketability of the units warrant it, the trust be treated as a WHC. This is not so in this case because the units are not marketable. Read literally, therefore, it might be assumed that the White Paper proposes to tax the trust as a CHC. It is reasonable to assume, however, that a trust of the particular type we are concerned with was not considered when the White Paper was drawn up. It seems to us that, to achieve equity in a case such as this, the trust should either continue to be treated as a conduit or be deemed to be a corporation entitled, if it falls within the definition of a NROIC, to elect to be taxed in that manner.

(c) Taxation of trusts for non-resident beneficiaries

We refer you to Appendix A where it will be seen that Elgistan Funds includes a trust, created in Canada by non-resident settlors, all of the beneficiaries of which are non-residents. A literal reading of the White Paper (5.57) indicates that any income (presumably including capital gains) accumulating in this trust would be subject to tax at 40 per cent which would be increased to approximately 50 per cent by provincial taxes.

It is acknowledged in the White Paper (5.58) that knowledge of the use to which trusts are put is limited and taxpayers, who believe that they would be unfairly treated under the proposals, are invited to make their views known to the government.

The particular trust under consideration here is a case in point. Its beneficiaries are all non-residents and its sole asset is a wholly owned NROIC which pays tax on its income in accordance with the rules governing such corporations. Following the principle recognized in the White Paper (6.40) that NROIC's are treated as non-resident persons, it would follow that any income of the trust should be permitted to flow from the NROIC into the trust and through to the non-resident beneficiaries with no tax in addition to the tax paid at the withholding tax rate when the income is earned in the NROIC. This is the present position as provided for in Secs. 63(5) and 106(4) of the Income Tax Act and we urge that these provisions not be changed. However, should they be changed we suggest that a trust such as this should be entitled to be treated as a corporation and to elect to be taxed as a NROIC. In this way the income flowing by way of dividend to the trust from its wholly-owned NROIC would not be subjected to double taxation, and income from accumulations in the trust would be taxed at the NROIC rate.

V. POSSIBLE TAX CONSEQUENCES TO ELGISTAN FUNDS

Earlier we pointed out that it is not possible to determine from the White Paper what the tax consequences of the proposed reforms would be to Elgistan Funds because in many areas the proposals are far from sufficiently explicit. Nevertheless, our study of the White Paper has raised in our minds questions of such a serious nature that, unless our fears prove to be quite unfounded, at best a complete reorganization of the Owners' investments in Canada would be called for and at worst they would be obliged to retire from the Canadian investment field.

In Appendix B, making certain assumptions, we have determined what portion of $100 of income from various categories of the investments of Elgistan Funds would remain for the Owners after payment of Canadian taxes, and to compare it with that remaining under existing law. In Appendix C, making similar assumptions, we have computed the impact of the capital gains tax.

For lack of clear indication to the contrary in the White Paper, we have assumed that it is proposed:

(1) To tax the open-end unit trust as a CHC.

(2) To tax NROIC's on income and capital gains at the rate of 25 per cent, under existing rules for determination of taxable income of NROIC's, with no credit for creditable tax.

The following startling results emerge:

	Portion of $100 remaining for the non-resident Owner		
	White Paper	Present Position	Increase in tax
Income flowing through the open-end unit trust to NROIC's from:			
WHC's	$56.25	$85.00	$28.75
Canadian bonds	37.50	85.00	47.50
Foreign investments	37.50	72.25	34.75
Capital gains flowing through the open-end unit trust to NROIC's from:			
WHC's	56.25	100.00	43.75
Canadian bonds and foreign investments	37.50	100.00	62.50
Capital gains flowing from CHC's (carrying on a business) to NROIC's	37.50	100.00	62.50

It is fair to say that, if a picture remotely resembling that painted above, were to emerge as a result of the proposed tax reform, little alternative would be left to Elgistan Funds but to retire from Canada. Furthermore, it should be noted that, in making the foregoing computations, we have not given any recognition to the proposal to tax non-residents on gains on disposal of their shares in CHC's (including NROIC's, if classed as such) and of their shares of WHC's in which they hold 25 per cent or more. Should these last-mentioned proposals be implemented as well, any attraction for continued investment in Canada would be difficult to find.

VI. RECOMMENDATIONS

It is recommended that:

(1) There be equity of taxation between non-residents who invest directly in Canada and those who, for good business reasons, invest indirectly through the medium of wholly-owned Canadian corporations or trusts. To achieve this objective it is recommended that:

(a) Capital gains on portfolio investments held indirectly by non-residents through Canadian corporations wholly-owned by non-residents be exempt from tax. To facilitate implementation of this recommendation it is suggested that:

(i) Such gains when realized by an NROIC be exempt from tax.

(ii) The definition of an NROIC be slightly amended to require 100 per cent beneficial ownership by non-residents and to restrict somewhat the present provisions governing derivation of income.

(b) The rate of tax on income applicable to NROIC's be fixed at the rate of Canadian withholding tax applicable to dividends paid to residents of the country in which the beneficial owners of the corporation are resident.

(c) The present provisions regarding the computation of taxable income of NROIC's remain unchanged.

(d) A private open-end unit trust, all of the units of which are beneficially owned by non-residents either continue to be treated as a conduit or be deemed to be a corporation entitled to elect to be taxed as an NROIC, provided, of course, that in all other respects it falls within the definition of such a corporation.

(e) The present provisions of the Income Tax Act (Secs. 63(5) and 106(4)) whereby income originating in an NROIC is permitted, after suffering tax at the NROIC rate, to flow to a Canadian trust for non-resident beneficiaries and thence to those beneficiaries free of further tax remain unchanged. Or, alternatively, the trust be treated as a corporation with the right to elect to be taxed as an NROIC, again provided that in all other respects it falls within the definition of such a corporation.

(2) The effective rate of capital gains tax suffered by non-residents on real property, partnership interests and branch assets not

exceed the maximum rate applicable to residents of Canada.

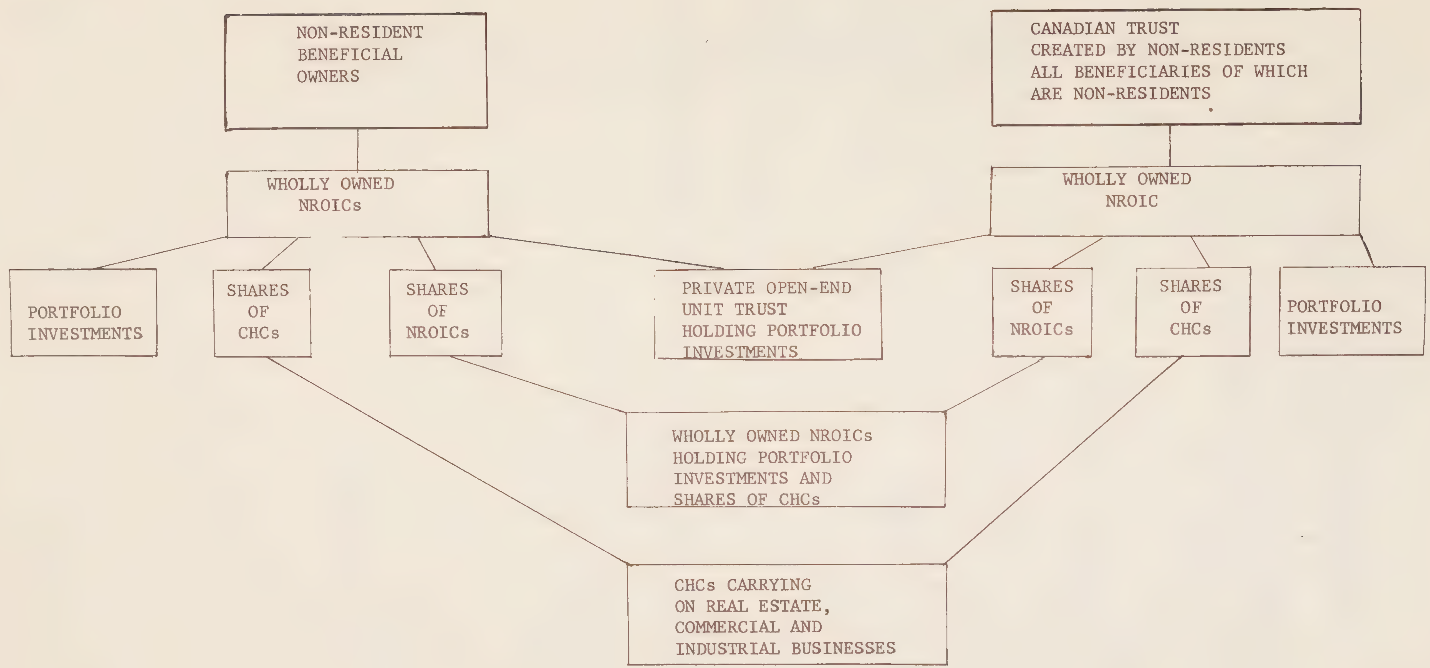
(3) The proposal whereby non-residents would be taxable on gains on disposal of shares of CHC's and of shares of WHC's in which 25 per cent or more is held be withdrawn.

(4) The proposal calling for a quinquennial revaluation of shares of WHC's be withdrawn.

APPENDIX A

ELGISTAN FUNDS

ABBREVIATED ORGANIZATION CHART



ELGISTAN FUNDS

COMPARISON OF POSSIBLE IMPACT OF WHITE PAPER TAXATION OF INCOME FLOWING FROM THE OPEN-END UNIT TRUST TO NROIC WITH PRESENT TAXATION OF THAT INCOME

Based on the assumptions that:

(1) The open-end unit trust will be taxed as a CHC.

(2) NROICs will be taxed at 25%, under existing rules for determination of taxable income, with no credit for creditable tax.

		Position based on above assumptions		Present position
Dividends from WCHs				
Dividend received by open-end investment trust		$ 100.00		$ 100,00
Gross-up at 50%		50.00		
Taxable amount		$ 150.00		Nil
Gross tax at 50%		$ 75.00		
Less credit		50.00		
Tax payable		$ 25.00		Nil
Net retention distributed to NROIC		$ 75.00		$ 100.00
NROIC tax thereon	(25%)	18.75	(15%)	15.00
Available for distribution to non-resident		$ 56.25		$ 85.00
Interest on Canadian bonds				
Interest received by open-end unit trust		$ 100.00		$ 100.00
Less tax		50.00		Nil
Distributed to NROIC		50.00		100.00
NROIC tax thereon	(25%)	12.50	(15%)	15.00
Available for distribution to non-resident		$ 37.50		$ 85.00
Foreign investment income				
Gross dividend or interest received by open-end unit trust		$ 100.00		$ 100.00
Foreign withholding tax		15.00		15.00
Net amount received		$ 85.00		$ 85.00
Gross tax	(50% of gross income)	$ 50.00		$ Nil
Less credit for U.S. withholding tax		15.00		
Tax payable		$ 35.00		$ Nill
Distributed to NROIC		$ 50.00		$ 85.00
NROIC tax thereon	(25%)	12.50	(15%)	12.75
Available for distribution to non-resident		$ 37.50		$ 72.25

ELGISTAN FUNDS

Impact of Possible White Paper Taxation of Capital Gains

Based on the assumptions that:

(1) The open-end unit trust will be taxed as a CHC.

(2) NROICs will be taxed at 25% on capital gains, with no credit for creditable tax.

Gains flowing through the open-end unit trust to NROIC	WHCs	Canadian bonds and foreign investments
Gain realized in open-end unit trust	$ 100.00	$ 100.00
Less allowable deduction	50.00	
Taxable amount	$ 50.00	$ 100.00
Tax thereon at 50%	$ 25.00	$ 50.00
Net retention distributed ro NROIC or realized by NROIC on redemption of units	$ 75.00	$ 50.00
NROIC tax thereon at 25%	18.75	12.50
Available for distribution to non-resident	$ 56.25	$ 37.50

Gains flowing from CHC (carrying on a business) to NROIC	
Gain realized in CHC	$ 100.00
Less tax thereon at 50%	50.00
Distributed to NROIC	50.00
Less NROIC tax thereon at 25%	12.50
Available for distribution to non-resident	$ 37.50

Note: No recognition has been given in the above to the proposal in the White Paper that non-residents be subject to gains realized on disposal of shares of CHCs and of shares of WHCs in which 25% or more is held.

APPENDIX "D"

Name: Elgistan Management Limited and Associated Companies

Subject: Canadian Taxation of Foreign Capital Invested in Canada through Non-Resident owned Investment Companies and Trusts with Non-Resident Beneficiaries

Analysis of Appendix "C" by Senior Advisor

This brief is being submitted by Elgistan Management Limited on behalf of a group of non-resident investors who are mostly residents of Great Britain or of the Republic of Ireland.

These investors have invested in Canada for a period of over forty years and the total value of assets managed in Canada exceeds $100 million, of which approximately $70 million is invested in Canada.

The investments are divided into two main categories:

(1) Investment in marketable or portfolio securities most of which, for ease of management, have been collected in a private unit trust fund (an entity similar in structure, but not in ownership, to the more widely known public "open-end" or mutual fund).

(2) Investment in non-marketable or direct ventures in the development and ownership of large office buildings in Western Canada, and in businesses engaged in merchandising construction equipment and building supplies, ranching, marketing and transportation of oil and toy manufacturing. Venture capital has also been provided to the cement industry.

The brief itself, after an introduction dealing with the impact of the implementation of certain of the White Paper Proposals on foreign investment in Canada (Pages 3 to 8), refers to the following specific points:

(1) Taxation of Capital Gains as Income. (Pages 9 and 10).

(2) Taxation of gains realized by Non-Residents on shares in which an interest of more than 25 per cent is held. (Page 10).

(3) Five Year Revaluation of Shares. (Pages 10 and 11).

(4) Taxation of Non-Resident-Owned Investment Companies. (Pages 12 to 14, and Appendices B and C).

(5) Taxation of Non-Resident-Owned Private Open-end Unit Trusts. (Pages 14 and 15).

(6) Taxation of Trusts for Non-Resident Beneficiaries. (Pages 15 and 16).

Members of the Committee will be interested in the recommendations appearing on Pages 19 and 20 of the brief, which read as follows:

"It is recommended that:

(1) There be equity of taxation between non-residents who invest directly in Canada and those who, for good business reasons, invest indirectly through the medium of wholly-owned Canadian corporations or trusts. To achieve this objective it is recommended that—

(a) Capital gains on portfolio investments held indirectly by non-residents through Canadian corporations wholly-owned by non-residents be exempt from tax. To facilitate implementation of this recommendation, it is suggested that—

(i) Such gains when realized by a Non-Resident-Owned Investment Corporation be exempt from tax.

(ii) The definition of a Non-Resident-Owned Investment Corporation be slightly amended to require 100 per cent beneficial ownership by non-residents and to restrict somewhat the present provisions governing derivation of income.

(b) The rate of tax on income applicable to Non-Resident-Owned Investment Corporations be fixed at the rate of Canadian withholding tax applicable to dividends paid to residents of the country in which the beneficial owners of the corporation are resident.

(c) The present provisions regarding the computation of taxable income of Non-Resident-Owned Investment Corporations remain unchanged.

(d) A private open-end unit trust, all of the units of which are beneficially owned by non-residents either continue to be treated as a conduit or be deemed to be a corporation entitled to elect to be taxed as a Non-Resident-Owned Investment Corporation, provided, of course, that in all other respects it falls within the definition of such a corporation.

(e) The present provisions of the Income Tax Act (Secs. 63(5) and 106(4)) whereby income originating in a Non-Resident-Owned Investment Corporation is permitted, after suffering tax at the non-Resident-Owned Investment Corporation rate, to flow to a Canadian trust for non-resident beneficiaries and thence to those beneficiaries free of further tax remain unchanged. Or, alternatively, the trust be treated as a corporation with the right to elect to be taxed as a Non-Resident-Owned Investment Corporation, again provided that in all other respects it falls within the definition of such a corporation.

"(2) The effective rate of capital gains tax suffered by non-residents on real property, partnership interests and branch assets not exceed the maximum rate applicable to residents of Canada.

"(3) The proposal whereby non-residents would be taxable on gains on disposal of shares of Closely-Held Companies and of shares of Widely-Held Companies in which 25% or more is held be withdrawn.

"(4) The proposal calling for a quinquennial revaluation of shares of Widely-Held Companies be withdrawn."

There is attached the usual summary of present tax laws, White Paper proposals and principal points of the brief.

Name: ELGISTAN MANAGEMENT LIMITED

Date Brief Received:

Principal Subject: Taxation of Capital Gains as Income

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act does not provide for the taxation of capital gains.	3.34 The rule that only one-half of gains or losses would be taken into account for tax purposes would put Canadians in approximately the same tax position regarding capital gains and losses on these shares as most of the non-residents who invest in Canada. Specifically, it would put them on approximately the same footing as American individuals and corporations and British individuals and corporations. (It would be impracticable to attempt to tax non-residents on their profits on the sale of small blocks of publicly listed Canadian shares.) 6.43 The general proposal to include capital gains in taxable income would require changes to the international provisions, including the extension of Canadian tax to gains by non-residents on the disposal of real property, partnership interests and branch assets in Canada. 6.44 Given the ease with which a gain on the sale of other assets can be transformed into a gain on the sale of shares of a corporation, it would also be necessary to tax certain gains by non-residents on the sale of Canadian shares. This need is strongly reinforced as regards closely-held Canadian corporations by the implications of the regime suggested for Canadian shareholders of those corporations. Since a Canadian can obtain full credit for the Canadian corporate tax paid by the corporation, and can deduct the full cost of his shares from his income when he sells those shares, he can afford to pay the full value of the corporation's assets (including creditable tax as an asset) when he buys the shares of the corporation.	Pages 9 and 10 of Brief This portion of the brief refers to the taxation of gains on Canadian buildings owned by non-residents. The brief suggests this proposal will weigh heavily against any decision by a non-resident to invest in real property in Canada.

6.45 Consider a corporation in this position:

Assets	
Cash	$ 5,000
Land, at cost (present value $150,000)	100,000
	$105,000
Shareholder's equity	
Common shares	$100,000
Retained earnings (after tax of $5,000)	5,000
	$105,000

A Canadian could afford to pay $160,000 for the shares of the corporation—$150,000 for the land, $5,000 for the cash, and $5,000 for the creditable tax. If he winds up the company, he would be treated as having purchased the land for $150,000, and as having received a dividend of $5,000 plus a taxable credit of $5,000. Offsetting this he would have a deductible loss of $10,000 on the shares. So he would receive $150,000 worth of land, the $5,000 cash in the corporation and a $5,000 tax refund from the government.

6.46 This is the appropriate result provided the vendor is taxable on his capital gain on the sale of the share. He and/or the owners before him would have paid tax on the full $60,000 on the sale of their shares. Canada would have collected one tax—and only one—on the $60,000. But the vendor must be taxable, or the $60,000 would escape tax. Therefore it is proposed that non-residents as well as residents be taxed on their gains on the sale of shares of closely-held Canadian corporations. This would be buttressed by a "back-up" provision to place a responsibility on the purchaser to ensure compliance. A system of "certificates of

Name: ELGISTANT MANAGEMENT LIMITED

Date Brief Received:

Principal Subject: Taxation of Capital Gains as Income

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	compliance" would be necessary for private company share transfers—an awkward but necessary evil. 6.47 The same implications do not apply in the case of widely-held Canadian corporations. Canadian shareholders would receive credit for only half of the corporate tax paid and would be entitled to deduct only half of their loss on the sale of their shares. Also, it would be impracticable to attempt to tax non-residents on their sales of small lots of these shares. Therefore it is proposed that only those non-residents who are selling shares out of a substantial interest (25 per cent or more) would be taxable in Canada.	

Name: ELGISTAN MANAGEMENT LIMITED

Date Brief Received:

Principal Subject: Taxation of gains realized by Non-Residents on sale of shares where an interest of more than 25% is held.

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act does not provide for the taxation of capital gains.	6.46 This is the appropriate result provided the vendor is taxable on his capital gain on the sale of the share. He and/or the owners before him would have paid tax on the full $60,000 on the sale of their shares. Canada would have collected one tax—and only one—on the $60,000. But the vendor must be taxable, or the $60,000 would escape tax. Therefore it is proposed that non-residents as well as residents be taxed on their gains on the sale of shares of closely-held Canadian corporations. This would be buttressed by a "back-up" provision to place a responsibility on the purchaser to ensure compliance. A system of "certificates of compliance" would be necessary for private company share transfers—an awkward but necessary evil. 6.47 The same implications do not apply in the case of widely-held Canadian corporations. Canadian shareholders would receive credit for only half of the corporate tax paid and would be entitled to deduct only half of their loss on the sale of their shares. Also, it would be impracticable to attempt to tax non-residents on their sales of small lots of these shares. Therefore it is proposed that only those non-residents who are selling shares out of a substantial interest (25 per cent or more) would be taxable in Canada.	Page 10 of Brief This portion of the brief recommends that a less all-embracing method be adopted.

Name: ELGISTAN MANAGEMENT LIMITED

Date Brief Received:

Principal Subject: Five-Year Revaluation of Shares of Widely-Held Corporations

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act does not provide for the taxation of capital gains.	3.33 Taxpayers other than widely-held Canadian corporations would include only one-half of their gains on the sale of these shares in taxable income and deduct only one-half of their losses. However, they would be required to revalue these shares to market value every five years and take one-half of the resulting gain or loss into account for tax purposes in that year. A special rate is proposed for widely-held Canadian corporations to avoid double tax. This is explained in Chapter 4. 3.34 The rule that only one-half of gains or losses would be taken into account for tax purposes would put Canadians in approximately the same tax position regarding capital gains and losses on these shares as most of the non-residents who invest in Canada. Specifically, it would put them on approximately the same footing as American individuals and corporations and British individuals and corporations. (It would be impracticable to attempt to tax non-residents on their profits on the sale of small blocks of publicly listed Canadian shares.) 3.36 The proposal that the accrued gains or losses on those shares be taken into account every five years is one of two exceptions to the general rule that capital gains and losses would be taxable only when they are realized. (The other exception concerns taxpayers who leave Canada.) Periodic revaluation would reduce somewhat the value of the half-gains rule. It would reflect the fact that these	Pages 10 and 11 of Brief This portion of the brief points out that the adoption of this proposal wil be injurious to the development of Canada by both domestic and foreign capital. The brief suggests this proposed tax may properly be described as a "wealth tax".

shares are readily marketable and that a taxpayer can, therefore, realize his gain or loss fairly easily at the time of his choosing. The shares of private companies do not have the same marketability.

Name: ELGISTAN MANAGEMENT LIMITED

Date Brief Received:

Principal Subject: Taxation of Non-Resident-Owned Investment Companies

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 70 of the Income Tax Act This section permits an investment company that meets certain tests to elect to pay a tax of 15% on its annual taxable income, that includes dividends received from Canadian companies. No further Canadian tax is imposed when such a company pays dividends or interest to non-residents of Canada. Foreign income taxes paid by such a company are allowed as an expense only, and are not a deduction from the 15% Canadian tax.	6.40 The proposed increase in withholding tax rates has implications for that category of corporation known as a "non-resident-owned investment corporation"; an entity taxed at 15 per cent on investment income but exempt from the obligation to withhold tax from distributions abroad. Such companies, while resident in Canada, are generally treated for tax purposes as non-resident persons. They constitute a convenient holding device for foreign investors in Canadian securities. The tax on such companies would be increased to match the rate of the non-resident withholding tax.	Pages 12 to 14 of Brief This portion of the brief relates to the taxes to be payable by a non-resident-owned investment corporation if certain of the White Paper proposals are implemented. It is recommended (1) that capital gains on portfolio investments be exempt from tax. (Page 12). (2) that the tax rate applied to a non-resident-owned investment company should be determined by the country of residence of the beneficial owner of its shares, and (3) that the tax on income or gains from foreign investments held by non-resident-owned investment companies should not be more severe than that presently imposed. Attention is drawn to the statement made on Page 13 of the brief that the company has no knowledge that non-resident-owned investment companies are used for avoidance or deferment of foreign taxes. Pages 17 and 18 of Brief and Appendices B and C.

This portion of the brief estimates the increased taxes payable if the White Paper proposals are adopted.

This calculation demonstrates that the only option left to such companies is to withdraw from Canada.

Name: Elgistan Management Limited

Date Brief Received:

Principal Subject: Taxation of Non-Resident-Owned private open-end unit trusts

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 63 of the Income Tax Act This section provides that income of a trust paid to a non-resident beneficiary is subject to a 15% Canadian tax.	5.56 Because a trust is not taxed on income which is payable to its beneficiaries during the year, many trusts do not pay any tax at all. Some of these trusts are in direct competition with widely-held public corporations and have as many beneficiaries (in this case usually unit holders) as some public corporations have shareholders. The tax rules give these trusts an advantage over their competitors. It is proposed that a trust be treated as a corporation if it has issued transferrable or redeemable units, each of which represents a specific undivided interest in the trust property. If the number of unit holders and marketability of the units warrant it, the trust would be treated as a widely-held corporation. If such a trust were a mutual fund, it would be taxed in the same manner as an incorporated mutual fund. 5.57 The fact that a trust is entitled to use the personal rate schedule in computing its tax means that income accumulated in a trust may bear significantly less tax than if the income were taxable to the beneficiaries, and the tax saving is not offset by a further tax when the funds are eventually distributed. (The number of accumulating trusts has increased significantly during the past few years.) If a trust is covered by the proposal set out in the preceding paragraph, this loophole would no longer be available. To close it for other trusts, it is proposed that income accumulating in such trusts be subject to a flat-rate federal tax of 40 per cent; provincial taxes would increase this rate to the neighborhood of 50 per cent and the corporate rate. A special relieving provision would	Pages 14 and 15 of Brief This portion of the brief refers to private open-end unit trusts owned by non-residents. It recommends alternatively that (a) a trust continue to be treated as a conduit, or (b) if treated as a corporation, be permitted to elect to pay tax as a non-resident-owned investment corporation.

reduce the rate in the case of trusts or estates arising on the death of someone whose economic circumstances were such that a 50-per-cent rate is not appropriate, provided no additional property is transferred to the trust by anyone else.

Name: ELGISTAN MANAGEMENT LIMITED

Date Brief Received:

Principal Subject: Taxation of Trusts for Non-Resident Beneficiaries

Present Tax Law

Section 63 of the Income Tax Act

This section provides that income of a trust paid to a non-resident beneficiary is subject only to a Canadian 15% tax.

Section 106-4 of the Income Tax Act

This section exempts from tax income of a trust paid to non-resident beneficiaries if such income consists of dividends or interest received from a non-resident-owned investment company.

Tax Reform Proposals

5.56 Because a trust is not taxed on income which is payable to its beneficiaries during the year, many trusts do not pay any tax at all. Some of these trusts are in direct competition with widely-held public corporations and have as many beneficiaries (in this case usually unit holders) as some public corporations have shareholders. The tax rules give these trusts an advantage over their competitors. It is proposed that a trust be treated as a corporation if it has issued transferrable or redeemable units, each of which represents a specific undivided interest in the trust property. If the number of unit holders and marketability of the units warrant it, the trust would be treated as a widely-held corporation. If such a trust were a mutual fund, it would be taxed in the same manner as an incorporated mutual fund.

5.57 The fact that a trust is entitled to use the personal rate schedule in computing its tax means that income accumulated in a trust may bear significantly less tax than if the income were taxable to the beneficiaries, and the tax saving is not offset by a further tax when the funds are eventually distributed. (The number of accumulating trusts has increased significantly during the past few years.) If a trust is covered by the proposal set out in the preceding paragraph, this loophole would no longer be available. To close it for other trusts, it is proposed that income accumulating in such trusts be subject to a flat-rate federal tax of 40 per cent; provincial taxes would increase this rate to the neighborhood of 50 per cent and the corporate rate. A special

Principal Points of Brief

Pages 15 and 16 of Brief

This portion of the brief recommends that Sections 63-5 and 106-4 of the present Income Tax Act be retained.

Alternatively, it is recommended that a trust with non-resident beneficiaries be permitted to elect to be taxed as a non-resident-owned investment company.

relieving provision would reduce the rate in the case of trusts or estate arising on the death of someone whose economic circumstances were such that a 50-per-cent rate is not appropriate, provided no additional property is transferred to the trust by anyone else.

APPENDIX "E"

Brief
to
Standing Senate Committee on Banking,
Trade and Commerce

Presented by William M. Mercer Limited

In the White Paper on Tax Reform the government welcomes public discussion of the proposals. In response we are pleased to submit this brief which we hope will be found helpful and constructive.

William M. Mercer Limited is the largest firm of consulting actuaries and employee benefit specialists in Canada, with ten offices and more than 240 employees. These include eighteen qualified actuaries, in addition to chartered life underwriters, lawyers, accountants and other professionals. The company celabrates its 25th anniversary on May 1st this year. We have over 2,500 clients, including industrial and commercial firms of all sizes, governments, crown corporations and associations. We therefore, feel well qualified to comment on the White Paper insofar as it affects employee benefit plans.

Our brief will be confined to the areas of employee benefits which are mentioned in the White Paper, specifically pension plans, deferred profit sharing plans, registered retirement savings plans, unemployment insurance and medical care plans.

The White Paper is sketchy as to the treatment proposed for pension plans and points out that "establishing an effective, fair system based on a benefit limit is not easy". (White Paper Section 2.49).

We submit that pension plans, deferred profit sharing plans and registered retirement savings plans should continue to be encouraged, because of their social and economic value, by favourable tax treatment. We accept the proposal in the White Paper that the main limit for tax purposes should be a limit on benefit outgo rather than on contribution input, provided the limit is high enough. A benefit limit is desirable since 90 per cent of pension plan members are in plans that already specify the benefit.

We believe that a proper tax system should embody the following principles:

Pensions

(a) The main limitation should be a maximum on the individual's retirement benefit, related to his earned income. The way in which such a limit might operate is discussed in the Appendix to this letter.

(b) The aggregate limit in a pension plan should be related to years of employment with the employing company. Otherwise very large sums could be claimed as tax deductions by short service employees (or by companies on their behalf), providing too great an incentive to develop tax avoidance schemes. We propose that the allowable pension should be 3 per cent of earnings for each year of service to a maximum of 75 per cent.

(c) A limit based on contribution input should be developed for money purchase pension plans and registered retirement savings plans. These plans are very numerous although generally of small size. The administrator of the popular "5 per cent plus 5 per cent money purchase" plan should not have to bother with complicated calculations as to the amount of expected benefits.

(d) Double taxation should be avoided, so that if any contributions are disallowed an appropriate part of the benefit should be tax free and not counted as part of the maximum benefit.

(e) If the government imposes dollar limits on contributions or benefits (which we do not recommend) these dollar limits should be escalated with some form of wage and salary index to allow for inflation. We propose if instituted that the limits be tied to the Canada Pension Plan Earnings Index.

(f) The rules respecting widow's pensions and disability pensions payable from pension plans should permit the payment of adequate benefits. The maximum should be a percentage of the employee's anticipated pension had he stayed to retirement age, rather than the present maximum which is a percentage of his accrued pension. The social justification for widow's and disability pensions is as great as that for retirement pensions, and both deserve special tax treatment.

(g) Insofar as possible, the rules for different classes of deferred income plans (pension plans, deferred profit sharing plans, registered retirement savings plans etc.) should be uni-

form, although complete uniformity may not be practicable.

(h) There should be some provision for modification of the tax on lump sum payments (as opposed to treating the lump sum as ordinary income as proposed in the White Paper), particularly in the case of death benefits from registered plans and lump sum retirement benefits from deferred profit sharing plans. This provision is necessary to avoid the possibility of a tax penalty as a result of participating in a registered plan. Repeal of Section 36 would place a severe penalty on many employees and members of deferred profit sharing plans. The averaging formula in the White Paper is of little or no help to a taxpayer who receives a lump sum upon his retirement or death.

As stated in the White Paper, a major problem is to develop a workable tax system for pension plans based on a benefit limit. We present in the Appendix a way in which we believe this can be achieved. The figures and percentages used are for illustration only, since we recognize that revenue and political considerations will govern the limit. We believe that the social and economic value of retirement plans justifies a high limit, which will enable taxpayers of all classes to accumulate reasonably adequate pensions.

Unemployment Insurance

We endorse the White Paper proposal that unemployment insurance benefits should be taxable and that employees' contributions to the Unemployment Insurance Fund should be deductible from income.

Medical Care Plans

The benefits from hospital and medical plans take the form either of "services" or reimbursement for service costs. Thus the plan may pay the hospital or physician directly or else the individual may receive payment in respect of his medical bills.

To tax the benefit from these plans would appear to be unfair and impracticable. We agree with the White Paper that the benefit should not be taxed, but as an offset medical expenses reimbursed by any plan, government and private, should not be allowed to count towards the medical expense deduction for tax purposes. The medical expense deduction of an individual should relate only to medical and hospital expenses not covered by any plan. This being so, a deduction might well be allowed for medical expenses actually paid by the taxpayer in excess of 1 per cent of income, rather than 3 per cent as at present.

Notwithstanding that the benefit from hospital and medical plans would not be taxed, we believe that there is social justification for permitting the employer to deduct his contributions or premiums for such plans. The employee should not be allowed to deduct his contributions but would not have the employer's contributions added to his income.

APPENDIX

Proposed method of applying a benefit limit to retirement plans for tax purposes

(1) As indicated in our brief we think there should be a maximum for tax purposes expressed in terms of pension outgo. This limit on the amount of a pension should be related to earnings in a period when they were highest (usually earnings shortly before retirement, for example 75 per cent of the best five years average pay.

(2) We do not favour an overall dollar limit on pensions, but if the government decides to impose such a limit, it ought to be increased from time to time as salaries and wages increase. A convenient way of doing this is to relate the limit to the Years Maximum Pensionable Earnings (YMPE) under the Canada Pension Plan. For example, the maximum pension might be the lesser of

(a) 75 per cent of the employee's best five years average pay and

(b) 8 times the YMPE at date of retirement (currently $42,400 a year).

(3) The maximum pension should be related to years of employment. We propose that the maximum should be reached in 25 years, rather than 35 years as at present, in order to help "late starters". Hence, we propose that the maximum pension per year of service should be 3 per cent of the best five years average pay.

(4) In addition to the pension for each year as indicated in the last paragraph the pension plan would be permitted to pick up "arrears". Thus the yearly maximum would be such amount as would bring the total pension purchased up to 3 per cent of the best five years average pay for each year of employment with the Company. Unless payments towards these "arrears" were allowed, it would be difficult if not impossible to operate final earnings pension plans or to upgrade career average plans to a current salary basis.

(5) In the case of money purchase pension plans and registered retirement savings plans a simple contribution limit should be applied. A contribution limit that appears to be reasonably appropriate would permit contributions to be made in any year up to 20 per cent of the employee's earned income but not exceeding the YMPE, such contributions to be shared in any way between employer and employee.

(6) In applying these contribution limits we see no good reason why a distinction should be made between employee contributions and employer contributions nor between regular and voluntary contributions.

(7) We suggest that the same contribution limit should apply to deferred profit sharing plans of all types. Contribution should be deemed to include reallocations of money forfeited by employees who left without full vesting.

(8) The limits should apply to an individual's total position under all plans, group or personal. In case the individual belongs to two plans of different types (e.g. a definite benefit pension plan with his employer and a Registered Retirement Savings Plan) some simple rules would have to be provided to limit the individual's contributions.

(9) Where for any reason an employee has exceeded the limits no further tax deductions would be permitted in respect of his contributions. Moreover where the ultimate pension exceeds the maximum of 75 per cent of earnings, we suggest that the excess should be subject to a pension surtax, possibly 50 per cent of the individual's marginal rate, to reflect the postponement of tax on the excess contributions and interest earned thereon.

(10) Pension funds should be credited with the dividend tax credit on the same basis as other taxpayers. The dividend tax credit is designed to eliminate double taxation. Since all payments out of pension fund are taxable, double taxation will occur unless the dividend tax credit is allowed.

APPENDIX "F"

Name: *William M. Mercer Limited*

Subject: *Employee Benefit Plans*

Analysis of Appendix "E" by Senior Advisor

This Brief is submitted by William M. Mercer Limited, the largest firm of consulting actuaries and employee benefit specialists in Canada. This firm has been in this business for 25 years and has over 2,500 clients.

The Brief refers to:

(a) The employee benefit plans mentioned in the White Paper, which are pension plans, deferred profit sharing plans, and registered retirement savings plans;

(b) Unemployment insurance; and

(c) Medical care plans.

Members of the Committee will observe that this Brief recommends:

(1) That employee benefit plans should continue to be encouraged, because of their social and economic value, by favourable tax treatment (Page 2).

(2) That a reasonble limit be placed on benefit outgo rather than on contribution input (Page 2), and

(3) A proposed method of applying a benefit limit to retirement plans for tax purposes (Appendix following Page 6).

There is attached the usual summary of present tax laws, White Paper proposals and principal points of the Brief.

Name: William M. Mercer Limited

Date Brief Received:

Principal Subject: Pension Plans, Deferred Profit Sharing Plans and Registered Retirement Savings Plans

Present Tax Law

A—Pension Plans

Section 11-1-i of the Income Tax Act

This section permits an employee to deduct from income:

(i) An amount not exceeding $1,500 withheld from his wages by an employer in respect of current services and paid into a pension plan, and payments by an employee in respect of past services while a contributor to the pension plan, and

(ii) An amount not exceeding $1,500 paid into a pension plan by an employee in respect of services rendered by him previous to the year while he was not a contributor to the plan,

or

(iii) An amount not exceeding $1,500 paid by a taxpayer into an approved fund as part of his dues as a member of a trade union.

Sections 11-1-g, 11-1-h and 76 of the Income Tax Act

Tax Reform Proposals

The proposals of the White Paper respecting pension plans and other employee benefit plans are contained in the following paragraphs:

2.50 While it is difficult to work out, the government believes in principle that such a system should be established. Unfortunately it is estimated that removal of the contribution limits would be quite expensive, and revenue considerations prohibit a switch at this time. Consequently we propose to retain the existing limits based on contributions, for the present, except for certain types of specified lump-sum payments into registered retirement savings plans. We also propose that plans that are primarily for the benefit of shareholders be denied registration until the switch is made to a benefit limit. The present contribution limits should be sufficient over a period to produce, along with the Canada Pension Plan and the old age security pension, reasonable retirement incomes. We suggest that any limits, whether on contributions or benefits, should be reviewed, perhaps every five years, to see that they are in reasonable accord with changing circumstances and prospects.

2.51 Most pension funds now are subject to regulation under the Pension Benefits Standards Acts of the provinces or of Canada. These control the investments of pension funds in a manner generally adequate for tax purposes. However, it is essential to be sure that tax-free funds cannot be diverted through investment in such a way

Principal Points of Brief

Pages 2, 3 and 4 of the Brief

This main portion of the Brief sets out the desirable features of a proper tax system respecting employee benefit plans.

The Brief particularly recommends a limitation be placed on retirement benefits payable to an individual.

Appendix contained in Brief

This portion of the Brief proposes a practical formula for applying a benefit limit to retirement plans.

These sections permit an employer to deduct from its income:

(i) Amounts not exceeding $1,500 per employee paid into a pension plan for services rendered in the year, and

(ii) Special payments made into a pension plan for past services of employees.

B—Deferred Profit Sharing Plans
Section 79C-7 of the Income Tax Act

This section permits an employer to deduct from its income for contributions made to a deferred profit sharing plans an amount not exceeding $1,500, less contributions made by the employer to a pension plan.

C—Registered Retirement Savings Plans

Section 79B-5-a of the Income Tax Act

This section permits a taxpayer to make a payment into a registered retirement savings plan and to deduct from income:

(i) An amount not exceeding $2,500, if the taxpayer is not a contributor to a pension plan, or

(ii) An amount not exceeding $1,500, less contributions made to a pension plan, where the taxpayer is a contributor to a pension plan.

as to bring current benefits to those who contribute to them and control them, and to provide sanctions to be applied when investments are made contrary to the rules. With adjustment to meet these two points it is proposed that the rules applying to investment of pension funds be the same as under the provincial and federal laws respecting pension plans. For registered retirement savings plans the permitted range of investments could be somewhat broader.

2.52 Three other changes are also proposed. First, the savings withdrawn from these plans would be taxed at ordinary rates, even if the amounts are withdrawn at the death of the contributor. A widow would be permitted to offset or reduce this income if she contributes all or part of the proceeds to a registered retirement savings plan of her own. Second, rules are required to ensure that the trustees of a pension or retirement plan fund are liable and responsible for paying taxes arising out of its operations. This would be necessary if, for example, beneficiaries leave Canada with the assets. Third, in view of the size and rate of growth of pension and retirement savings funds, due in part to their tax-free status, it is reasonable to require that the bulk of them be productively invested in Canada. Consequently it is proposed that to qualify for the tax-free status of registered pension plans or registered retirement savings plans, these plans must invest no more than 10 per cent of their assets in foreign securities or other foreign investments.

2.57 It is not proposed to remove the present averaging formula for farmers or fishermen, who would be free to use either system. But a year included in a block of years averaged under the present system could not be used in applying the proposed new formula. Current provisions permitting averaging over a period for special lump-sum business receipts from recaptured capital cost

Name: William M. Mercer Limited

Date Brief Received:

Principal Subject: Pension Plans, Deferred Profit Sharing Plans and Registered Retirement Savings Plans

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	allowance, inventory revaluation, the sale of inventory and the sale of receivables would be phased out. For corporations the phase-out would begin once the transition to one rate of corporate tax is complete. Lump-sum payments out of pension funds, or from employers on retirement, could be averaged on the new formula or, subject to certain safeguards, paid into a registered retirement savings plan, over and above the normal limit on such payments. A similar opportunity to pay extra amounts into registered retirement savings plans might be afforded to those having certain other types of irregular or short-term incomes such as authors and professional athletes. Withdrawals from such registered plans would be fully taxable and made on a regular and controlled basis.	
	4.60 The government does not propose a refund to pension plans and other tax-free entities of the corporate tax paid by the corporations from which they receive their dividends. It considers that tax-free status of the investment income of the pension plan, including capital gains, is sufficient tax concession to these entities.	

Name: William M. Mercer Limited

Date Brief Received:

Principal Subject: Unemployment Insurance

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 10-1-h of the Income Tax Act This section provides that benefits received under the Unemployment Insurance Act are not subject to Income Tax. Contributions made by employees for Unemployment Insurance levies are not deductible when computing income subject to tax.	The White Paper proposals respecting Unemployment Insurance are contained in the following paragraphs: 1.36 The government has decided that it would make the tax system fairer if the treatment of unemployment insurance were changed to permit workers to deduct their contributions to the fund and to require them to pay tax on benefits received. Many of the benefits are received by employees with average or higher than average incomes who are unemployed for relatively short periods, and whose annual incomes equal or exceed the annual earnings of others. The higher their incomes the greater the tax benefit. It is fairer to tax them on this part of their income, as long as we permit all employees to deduct their contributions. Anyone on unemployment insurance benefits for most of the year is likely to pay little or no tax. 2.22 The most important of these changes would make unemployment insurance benefits taxable and make employees' contributions to the Unemployment Insurance Fund deductible from income. Many employees receive unemployment insurance benefits for part of a year although they may have earned substantial other income during the rest of the year. Tax exemption for these payments is unfair to the person who earns the same total income but who must pay more tax. The higher the employee's regular income the greater the advantage of the present tax-exempt treatment of benefits.	Page 5 of the brief endorses the White Paper proposals respecting unemployment insurance.

Name: William M. Mercer Limited

Date Brief Received:

Principal Subject: Medical Care Plans

Present Tax Law

Section 27-1-c of the Income Tax Act

This section permits a taxpayer to deduct from income subject to tax medical, hospital and other similar expenses to the extent such expenses exceed 3% of the taxpayer's income for the year.

Premiums paid by a taxpayer for sickness or hospitalization insurance are not considered to be a medical expense. Further, insurance recoveries are not deductible from medical expenses paid.

Section 27-4a of the Income Tax Act

This section provides that medical expenses reimbursed to a taxpayer under the laws of a province or of Canada may not be included with medical expenses not so reimbursed for purposes of computing the deduction from income referred to above.

Tax Reform Proposals

The White Paper proposals respecting Medical Expenses deductible from income are contained in the following paragraph:

2.20 Now that medical care as well as hospital care are covered by comprehensive public plans supported to a large extent by federal expenditures, it is proposed to change somewhat the basis on which medical expenses may be claimed. No expenses paid or recoverable from such public plans now are included in medical expenses for purposes of the Income Tax Act, nor any premiums paid by taxpayers toward such plans. The first provision is necessary to reflect the fact that such plans are already supported out of federal revenue; the second is essential for fairness because some provinces finance their plans largely from general revenue, which cannot be identified or allowed as a deduction, and others by premiums of various sizes. It is now proposed, as the royal commission recommended, that all medical expenditures for which a taxpayer has been reimbursed, or is entitled to be reimbursed, from an insurance or prepayment plan should not be classed as medical expenses for tax purposes. Instead premiums or contributions paid to plans other than government plans would be classed as medical expenses for this purpose. Medical expenses not recoverable from either public or private plans would continue to be deductible where they exceed 3 per cent of the taxpayer's income. One other change in the law will also be proposed to place contributions to public medical care plans on the same basis as contributions to

Principal Points of Brief

Page 5 of the Brief

This section of the Brief recommends that deduction for medical expenses in excess of 1%, instead of the present 3%, be allowed.

public hospital care plans. This would provide that an employer's contributions on behalf of an employee be treated as a taxable benefit received by the employee.

APPENDIX "G"

Brief No. 2 by Wm. M. Mercer Limited.

Brief on the taxation of lump sum payments from Pension Plans and Deferred Profit Sharing Plans

This brief on the taxation of pension plans and deferred profit sharing plans is presented by William M. Mercer Limited on behalf of a group of interested companies. The brief is endorsed by the following companies, some of whom are also submitting separate briefs on this matter. The year of first establishment of a pension plan or deferred profit sharing plan providing lump sum benefits is shown after the name of each company.

Canada Packers Limited (1953)

Dominion Foundries and Steel, Limited (1938)

Grant & Toy Limited (1953)

Shell Canada Limited (1939)

Simpsons Limited (1919)

Simpsons-Sears Limited (1919)

The above companies operate profit sharing plans providing deferred benefits, which cover a total of approximately 40,000 members and have assets exceeding $240 millions. The plans have been in operation for many years. They have been highly successful, measured either by the appreciation of the staff, the retirement benefits paid out or the size of the accumulated funds.

Profit sharing plans that provide benefits on a tax deferred basis may either be registered as "deferred profit sharing plans" under Section 79C or as "pension plans" under Section 139 (1) (ahh) of the Income Tax Act. It is not necessary in this brief to distinguish between them as the points we wish to make apply to both types. Under either type the payment due to a member who retires or leaves the company may be taken in the form of a lump sum.

It is generally agreed that profit sharing improves morale and provides an incentive to employees, by giving them a desirable form of participation in the success of the employing company. The companies endorsing this brief are well satisfied with the incentive and employee satisfaction generated by their profit sharing arrangements.

Experience has shown that lump sum payments are used wisely. They provide the retiring employee with the flexibility to reorganize his affairs on retirement. He may pay off a mortgage or other debt or even start a small business. In these and other ways the employee may use his lump sum to help him become self-sufficient in retirement.

Many have found that through careful investment or the retention of common stock acquired through a plan, they have been able to offset the inflationary pressures that beset those with fixed incomes.

The advantages of lump sum settlements are recognized in several countries where they are permitted on a very favourable tax basis.

The White Paper proposal apparently would repeal Section 36 of the Income Tax Act which allows the taxpayer the option of having a lump sum taxed at the average rate of the last three years. An averaging provision is included in the White Paper but this is far less favourable to the taxpayer than either the present system or the Carter Commission proposal. The following simple example shows the effect of the White Paper proposal:

Example

A married employee earning $8,000 in each of the last four years retires with a lump sum payment of $30,000 from a profit sharing plan. He has deduction as specified on page 28 of the White Paper i.e. $3,050 in total.

(1) Present tax under Section 36 at present rates—$5,202

(2) Tax under Section 36 if new tax rates apply—$4,935

(3) Proposed tax basis—ordinary income—$10,688

(4) Proposed tax basis—with income averaging—$9,333

It will be seen that the tax on the lump sum payment will be more than doubled if it is taxed as ordinary income. If the income averaging provision is used the tax will be increased by 80 per cent. Evidently the income averaging rule is of little significance where lump sums are paid at retirement. Moreover, the change is most adverse to those with low incomes. Considering employees of different incomes, the percentage increases in tax are greatest for those with the lowest

incomes and least for those with highest incomes.

It is submitted that a plan paying lump sums at retirement or termination of employment has a social value at least equal to that of a plan providing a fixed pension income. Since such a plan deserves equally favourable tax treatment, the taxation of the lump sum should not be disproportionate to the taxation of an equivalent pension.

The averaging system in the White Paper might be appropriate for persons who have exceptional earnings in one year such as athletes and actors. It is however, quite inappropriate if applied at retirement to a lump payment representing an employee's lifetime savings. Such savings are of course intended to provide income after retirement and the rate of tax should properly be that applicable to the individual's pension income. The tax proposed in the White Paper would far exceed the tax calculated on the above basis.

Looking at the operations of the plans retrospectively, the income tax saved on contributions for the employee and interest earned on his credits is at the average top bracket rate during his working life. Tax has been saved at a relatively low rate because the employee's earnings in the past were lower than at retirement. The benefit derived from his contributions and interest should not be taxed at a much higher rate, calculated as if the lump sum were income in a single year or as if it were added to his ordinary income over the previous four years.

It appears that the government has become sensitive about Section 36 because of the way in which it was abused through certain types of executive pension plan. Recognizing the revenue loss if large sums can be placed in a registered plan in one year and withdrawn under Section 36 in the next, the repeat of Section 36 is too drastic a solution and would probably destroy profit sharing plans as we know them. Executive pension plans are now closely controlled and the amounts which may be taxed under Section 36 are strictly limited by the 1965 amendment. Accordingly it is not necessary to repeal Section 36 in order to protect the revenue.

It is submitted that Section 36 as it operates at present, is fair and appropriate. The averaging system proposed in the White Paper is of little help to individuals who receive lump sums and is too complicated for them to understand.

We urge the retention of Section 36 for lump sum payments. Even if it were decided, erroneously in our view, that Section 36 should no longer apply, surely its elimination should be effected in such a way that retroactive application of penal tax should be avoided. Certainly retroactive taxation must be avoided for long service employees whose retirement plans have been made in the expectation of receiving a lump sum. Most of these employees have reached a stage in their career where they would not have sufficient time to adjust their affairs to cope with the tax reform proposals. They could well be forced to take an early retirement in order to withdraw from the plan before the new tax system came into force. We believe that the wholesale dissipation in 1971 of funds accumulated for employees' retirement would be socially undesirable and would be inflationary.

We request that you reconsider the White Paper proposals that lump sums from profit sharing plans should be taxed as if they were ordinary income. We believe that such a drastic change would be resented as unfair by the members. We believe that it would result in withdrawal of very large sums to anticipate the tax change and in the probable discontinuance of many successful retirement plans.

APPENDIX "H"

Name: William M. Mercer Limited—

Subject: Lump Sum Payments from Pension Plans and Deferred Profit Sharing Plans

Analysis of Appendix "G" by Senior Advisor

This brief has been prepared by William M. Mercer Limited, pension consultants, endorsed by the following interested companies:

	Year of Establishment of Pension Fund
Canada Packers Limited	1953
Dominion Foundries and Steel Limited	1938
Grand & Toy Limited	1953
Shell Canada Limited	1939
Simpsons Limited	1919
Simpsons-Sears Limited	1919

The above companies operate profit sharing plans providing deferred benefits, which cover a total of approximately 40,000 members and have assets exceeding $240 millions.

The brief explains the greatly increased taxation of pension benefits that will result if the White Paper proposals respecting lump sum payments from pension funds are adopted.

It recommends retention of Section 36 of the present Income Tax Act.

There is attached the usual summary of present tax laws, White Paper proposals and principal points of the brief.

Name: William Mercer Limited—On behalf of Interested Companies

Date Brief Received:

Principal Subject: Lump Sum Payments from Pension Plans and Deferred Profit Sharing Plans

Present Tax Law

Section 36 of Income Tax Act

This section permits an individual who receives a single payment from a pension plan or deferred profit sharing plan on death, withdrawal or retirement from the plan:

(a) to set apart from other income of the year, the single payment received from the plan, so that he does not have to pay graduated income taxes on the increased income for the year, and

(b) to pay a special tax on the payment received from the plan, based on the average rate of tax paid by the individual in the three years preceding the year in which the payment from the plan is received.

Tax Reform Proposals

The White Paper proposes that savings withdrawn from pension and other plans be taxed at ordinary rates.

2.52 Three other changes are also proposed. First, the savings withdrawn from these plans would be taxed at ordinary rates, even if the amounts are withdrawn at the death of the contributor. A widow would be permitted to offset or reduce this income if she contributes all or part of the proceeds to a registered retirement savings plan of her own. Second, rules are required to ensure that the trustees of a pension or retirement plan fund are liable and responsible for paying taxes arising out of its operations. This would be necessary if, for example, beneficiaries leave Canada with the assets. Third, in view of the size and rate of growth of pension and retirement savings funds, due in part to their tax-free status, it is reasonable to require that the bulk of them be productively invested in Canada. Consequently it is proposed that to qualify for the tax-free status of registered pension plans or registered retirement savings plans, these plans must invest no more than 10 per cent of their assets in foreign securities or other foreign investments.

2.53 Income tax is levied on a year's income at a time, at a rate that normally depends on the size of that year's income alone. But some types of income are irregular, and tax must be paid at a higher rate in a year when income is abnormally high. This may cause taxpayers with irregular or varying incomes to pay significantly higher taxes

Principal Points of Brief

This brief submits that Section 36 of the present Income Tax Act should be retained, and supplies reasons, based on practical experience to support this view.

Name: William Mercer Limited—
On behalf of Interested Companies

Date Brief Received:

Principal Subject: Lump Sum Payments from Pension Plans and Deferred Profit Sharing Plans

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	over a series of years than those whose incomes are more regular. Special provisions in the existing law permit farmers and fishermen to average their incomes over a block of five years, authors over three years, and businessmen on certain unusual types of income over three or five years. Certain types of single payments out of pension funds, or by employers on retirement of an employe, can be taxed at the average rate of tax paid by the employee over the preceding three years. 2.54 The introduction of a capital gains tax, particularly one in which accrued gains on shares in widely-held Canadian corporations are taxed periodically, would increase the need for a more general averaging formula, because many more taxpayers will occasionally have incomes much higher than their average incomes. The royal commission noted this need under a capital gains tax and recommended for all taxpayers an averaging formula similar to that now available to farmers. It also recommended that "deposit averaging" be permitted, under which a taxpayer could deposit with the government a portion of his income—on an interest-free basis—and pay no tax on it until it was withdrawn. 2.55 The government has reached the view that a general averaging formula should be available to all individual taxpayers. However, it proposes a much simpler and more automatic system than the royal commission did. Averaging would introduce new complications for the taxpayer, and new need for keeping records. Moreover, the sys-	

tem proposed by the commission would confront the taxpayer with difficult choices, and the possibility of choosing a period that would later prove to be against his own interest. The proposed simpler method can be applied automatically by the central tax assessment computer, using the information for previous years stored in its memory. Moreover, it would work smoothly and fairly even when tax rates change. It should also be noted that averaging options can be very expensive in terms of revenue, particularly at a time when incomes are growing rapidly, and there must be safeguards against giving the benefits of averaging to what are simply growing incomes.

2.56 The method proposed is as follows: when the income in the taxation year exceeds the average of the taxpayer's income in the preceding four years by more than one-third, the excess income would be taxed as though it were subject to a graduated rate schedule in which the income brackets to which each rate applied were five times as wide as normal. The formula is necessarily complicated but this would not concern taxpayers because it can be applied on their behalf. Tables 11 and 12 show the application of the formula in more detail.

2.57 It is not proposed to remove the present averaging formula for farmers or fishermen, who would be free to use either system. But a year included in a block of years averaged under the present system could not be used in applying the proposed new formula. Current provisions permitting averaging over a period for special lump-sum business receipts from recaptured capital cost allowance, inventory revaluation, the sale of inventory and the sale of receivables would be phased out. For corporations the phase-out would begin once the transition to one rate of corporate tax is complete. Lump-sum payments out of pension funds, or from employers on retirement, could

Name: William Mercer Limited—
On behalf of Interested Companies

Date Brief Received:

Principal Subject: Lump Sum Payments from Pension Plans and Deferred Profit Sharing Plans

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	be averaged on the new formula or, subject to certain safeguards, paid into a registered retirement savings plan, over and above the normal limit on such payments. A similar opportunity to pay extra amounts into registered retirement savings plans might be afforded to those having certain other types of irregular or short-term incomes such as authors and professional athletes. Withdrawals from such registered plans would be fully taxable and made on a regular and controlled basis. The White Paper proposes a new formula to permit the averaging of income. 2.58 It would not be possible to bring the general averaging arrangement into effect immediately. It would be necessary to have the records of assessed income for previous years for all or nearly all taxpayers before the system could be fairly used. Until this accumulation of information reaches five years it would be necessary to use a shorter series of years, with a lower "threshold level". 2.59 A second and more serious practical problem is whether years in which there is no taxable income for one reason or another should be counted for averaging, and whether years before such a year of no income should be used. It seems unfair to permit a taxpayer to include in averaging any years in which he or she is claimed as a dependant for purposes of the married exemption. The same is true of students at school or university. Counting such years of no income, or income below the	

exemption limit, might well reduce tax for several years on people who have chosen to be outside the labour market and in respect of whom dependants' deductions have been granted. It is therefore proposed that a married person may use for averaging only an unbroken series of years after being claimed as a dependant by his or her marriage partner. A person under 25 years of age could use only an unbroken series of years since the last year in which he had no tax to pay. These rules are not wholly satisfactory, but no simple and practical alternative has been found. Those prevented by such rules from using more than, say, two previous years for averaging might be permitted to assume an arbitrary income of $5,000 per year in the years excluded.

APPENDIX "I"

The Government White Paper

Proposals for Tax Reform

A Brief

The Royal Architectural Institute of Canada

CONTENTS

March 26, 1970.

The Senate Committee on
Banking, Trade and Commerce,
The Senate, Ottawa, Canada.

Gentlemen:

The Government White Paper
Proposals for Tax Reform

It is a pleasure to submit the required copies of this brief on behalf of The Royal Architectural Institute of Canada.

We trust that this submission furnishes information that will be helpful to your study and that it truly reflects the opinions and recommendaions of members of the architectural profession in Canada as well as those of the provincial component associations.

Yours respectfully,
William G. Leithead, FRAIC,
President, R.A.I.C.

SUMMARY AND RECOMMENDATIONS

A. SUMMARY

1. Scope

This brief is primarily concerned with the *principles* of the proposals for tax reform and deals with those considered to be of particular interest to members of the architectural profession in Canada, to their respective provincial associations and to the Royal Architectural Institute of Canada.

2. Related Effects in the Construction Industry

The Institute, while not attempting to predict the impact of the tax reform proposals on the construction industry as a whole, does anticipate restrictive trends that are strongly opposed to the achievement of high, sustained and balanced growth in the interest of national prosperity.

3. The Nature of Architectural Practice

The differences between the practice of architecture and certain other professions and businesses are frequently not understood. An outline of comparison is provided in the text.

4. Proposals Affecting Practice and Employment

(a) Accrual basis of computing taxable income

(b) Entertainment and related expenses

(c) Employment expenses—conventions

(d) Depreciation—capital cost allowance

(e) Closely-held corporations

5. Proposals Affecting Architectural Organizations

(a) Employment and entertainment expenses

(b) Investment income—clubs and other non-profit organizations

(c) Fellowships, scholarships and research grants

6. Recognition of Possible Benefits

The brief acknowledges that not all proposals for tax reform will affect the profession adversely and those that may be of benefit are duly recognized.

7. Toward a Better Understanding

The Institute proposes the retention by federal government of knowledgeable members from private practice to participate in further development of taxation proposals that affect their professions.

8. The Royal Architectural Institute of Canada

Appendix "A" provides a brief outline of the Institute organization.

9. Component Provincial Associations

Appendix "B" lists the component provincial associations.

B. Recommendations

1. That taxpayers in the professions continue to have the choice of reporting income either on the accrual basis or the cash basis (page 7).

2. That architects in professional practice be allowed to deduct from income all expenses necessary for the maintenance and development of their practice including promotion, entertainment, club dues and travel; (page 8).

3. That for the professions, the cost of attending or sending employees to annual meetings, conventions, assemblies, professional seminars or workshops of an on-going educational nature should all be allowed as an operating expense—not subject to income tax; (page 9 and 13).

4. That the existing system of computing capital cost allowance be retained; (page 10).

5. That the existing rate of corporate tax on the first $35,000 of income be retained; (page 11).

6. That the Royal Architectural Institute and the component provincial associations be classified with those non-profit associations or societies which will remain exempt from tax on investment income (page 14).

7. That income from fellowships, scholarships, bursaries and research grants be exempt from tax; (page 15).

8. That the Government should retain knowledgeable professionals from private practice and the public service to participate in the further development of taxation proposals that directly affect their professions (page 17).

A Brief presented on behalf of the Royal Architectural Institute of Canada at the request of the President, the Officers and Members of RAIC Council and prepared by W. A. Salter, FRAIC, Director of Professional Services.

1. Introduction and Scope

The Royal Architectural Institute of Canada recognizes the need for measures of tax reform. In principle it supports all proposals that have been introduced to eliminate inequities, to assist those in the very low income group, to encourage private enterprise, to curb abuses and exploitation under the present system.

The Institute is opposed in principle to all proposals that do not support the Economic Council of Canada objective—high, sustained and balanced growth in the interest of national prosperity.

The proposals tabled in the 1969 Government White Paper by Hon. E. J. Benson, Minister of Finance, establish general principles but lack much of the detail and definition necessary to determine the effects on any particular segment of the tax-paying public.

This brief therefore is concerned in principle with those proposals that are interpreted as being significant to the professions and in particular to architects, their professional associations and to the Royal Architectural Institute of Canada.

2. Related Effects—The Construction Industry

The design professions which include architects, engineers, landscape architects, planners and others are integral members of the total construction team within the national industry.

The inter-dependence today with each other and with all members of the team has never been more clearly established and their traditional concern with buildings and structures now extends to all aspects of the total environment.

In principle therefore, a proposal that adversely affects any one member of the team will be reflected in others. Even more important are proposals that may discourage new construction, urban growth and development through a lack of incentive by those in a position to take the initiative.

The construction industry is plagued with the problems generated by the cyclic flow of supply and demand. The cost of gearing up and down to meet changing conditions has resulted in staggering costs in terms of money, manpower, insecurity and the waste of human resources.

In principle, the indirect effects of tax reform proposals should be to stabilize and sustain productivity, thereby ensuring incomes and the resultant tax revenue.

3. The Nature of Architectural Practice

The registered architect in Canada has reached the stage of being able to practice only after a long period of post-secondary school education which normally includes five years at university and three in office experience. When registered in the provincial association of his choice he automatically receives membership in the Royal Architectural Institute of Canada.

Firms vary in size from a few individuals who practice alone with a limited but highly paid staff, to large partnerships with correspondingly larger staffs of competent assistants, consultants, technicians, draughtsmen and secretarial help.

They all have in common the need to provide extensive office space, working capital and competent staff in order to meet the high standards of the professional service required.

They also have in common the problem of meeting regular operational costs of payroll, consultants, rent, taxes and equipment from income received in payment cycles that are highly irregular and frequently extend over a period of months—even years.

The maintenance of a successful practice and its high order of professional competence and responsibility requires of the architect, on-going education, continual client contact development and relationships, and participation with his colleagues in public and professional affairs in the areas of community, provincial and national interest.

4. Proposals Affecting Architectural Practice

4—1 Chapter 5, Sections 5-46 and 5-47—

Taxpayers in the Professions

Accrual Basis of Computing Taxable Income

The proposal to impose on professionals in practice the accrual basis for reporting income for tax purposes in lieu of the existing choice between accrual or cash basis is likely to create serious financial problems for many architectural firms.

The principle of paying taxes on potential income not yet received is considered to be unreasonable.

In architectural practice, accounts receivable are not the 30-day commercial variety. Normally they will run for months before a progress invoice is submitted and frequently with provincial and federal government work, the period extends for a year or longer, depending on the nature of the project.

In effect, the architect is presently financing the client for his professional work over long periods and for smaller firms in particular the increased obligation to pay taxes prior to receipt of his fees will impose additional expense likely to be met by additional borrowing of bank money, thereby increasing expenses and decreasing profits.

The present choice of the cash or accrual basis for reporting income by the professions as enjoyed by farmers and fishermen and who may continue to do so under the new proposal is considered to be fair and reasonable—that it does not provide "unwarranted advantages" as stated in the Proposals for Tax Reform and that it should be retained as one of the few measures available to the practitioner to stabilize annual income.

> It is recommended that taxpayers in the professions continue to have the choice of reporting income either on the accrual basis or the cash basis.

4-2 Chapter 5., Section 5.9—Entertainment Related Expenses

Architectural Practice Development

It is proposed that the Income Tax Act specifically deny deduction for entertainment expenses and the cost of dues for membership in social or recreational clubs.

In the practice of architecture, close client contact is extremely necessary for the development of income and for a successfully operated project. In addition the frequent meetings with associate consultants are essential for project co-ordination. If the practice of architecture is to be classified as a business it is unreasonable to deny the expenses for business and design development, particularly since the main commodity for selling is talent represented by working hours—not a manufactured item.

Architects by their own provincial association regulations are denied the privilege of advertising and promotional expenses associated with the normal solicitation of business. This proposal is considered to be severe and unfair.

> It is recommended that all architects be allowed to deduct from income those expenses necessary for the maintenance and development of their professional practice including promotion, entertainment, club dues, travel etc.

4-3 Chapter 2., Section 2.11—Employment Expenses

Chapter 5., Section 5.9—Entertainment Expenses Conventions

The proposals provide that the cost of attending or sending employees to conventions will not be permitted as a deduction in determining business income.

No mention is made of annual meetings of associations, professional seminars, etc., and it will be evident that clear definition is required on this matter so that abuses are not equated with these essential means of maintaining high standards of performance as well as communication and exchange in the professional fields.

Any reduction in financial support or incentive to attend such meeting will curtail if not eliminate these important functions which have historically done so much to preserve and expand provincial and national unity among members of the architectural profession.

It is recommended that members of the profession be allowed to deduct from income the expenses of attending the annual meeting of their provincial association and annual assembly of their national institute as provided under the existing legislation.

4-4 Chapter 5., Sections 5.11-5.19—Depreciation

Capital Cost Allowance

The White Paper records that the present system of computing depreciation "has served Canada well" and "has acted as an incentive to taxpayers to modernize and improve their business facilities."

Despite these favourable comments, Section 5.17 proposes three changes with respect to buildings and which are a matter of direct concern to the architectural profession and to the construction industry:

(a) It is proposed that a person who inherits property will for tax purposes inherit the tax cost of that property to the deceased.

(b) It is proposed to disallow from other income a loss from rental property if that loss is created by interest, property taxes or capital cost allowances.

(c) It is proposed to create a separate depreciation class for each rental building that costs $50,000.00 or more.

In principle, these proposals are considered to be very detrimental to the development of new housing and commercial property in terms of discouraging initiative and expansion and promoting increased rental rates and costs of properties.

It is recommended that the existing system of computing capital cost allowance be retained.

4-5 Chapter 4., Sections 4.20-4.33—Closely-Held Corporations

Incorporation of Architectural Practice

The proposal to remove the existing rate of corporate tax on taxable income up to $35,000.00 and establish a flat rate of approximately 50 per cent will be a disadvantage to many architects in the process of establishing their operations by means of incorporation.

Several of the provincial architectural associations have recently obtained legislation to enable architectural practices to be incorporated. Among the advantages considered was the ability to enjoy the existing tax rate on the first $35,000.00 of income.

This important benefit would make it possible for the small firm to accumulate the necessary capital for the conduct and expansion of the practice. Its denial will discourage the formation of such corporations and curtail the expansion of those existing

It is recommended that for corporations, the existing tax rate on the first $35,000.00 of income, be retained.

5. Proposals Affecting Architectural Organizations

5-1 Chapter 2., Section 2.11—Employment Expenses
Chapter 5., Section 5.9—Entertainment Expenses

The noted specific proposals referred to in "The Individual and Family in Tax Reform" and in "Business and Property Income", are duplicated in respect to their affect on our professional associations and the Royal Architectural Institute of Canada.

Conventions

The proposals to deny deduction for the costs of attending or sending employees to "conventions" will adversely affect the basic function and effectiveness of all professional organizations.

A clear definition of the word convention is required in order to establish the abuses (which should be taxed) and to ensure that these are not equated with legitimate meetings to conduct professional affairs.

If we are to believe that "conventions" will include Annual Meetings of the nine provincial architectural associations and of this

Institute, as required by the By-laws, the strongest plea for their exemption is submitted.

These established meetings are the logical and proper occasions for the election of officers, consideration of reports and programs, budgets, professional discussion and development. Continuity is essential to the health of these organizations and any proposal that adversely affects the incentive of a member to attend is considered to be destructive.

Conferences, Seminars and Workshops

If we are also to believe the "conventions" will also include professional and inter-disciplinary conferences, seminars and workshops, many of which are instigated and sponsored by both provincial and federal government departments, these proposals are in direct conflict with the intent and objectives of the sponsors to the degree that they discourage attendance.

> It is recommended that the cost of attending or sending employees to annual meetings conventions or conferences of professional organizations be allowed as an expense—not subject to income tax.

5-2 Chapter 5, Section 5.54—Investment Income of Clubs and other Non-profit Organizations

Investment Portfolios Subject to Tax.

The proposal to tax at the corporation rate the investment income of some organizations and to exempt others is discriminatory and unfair.

The interest on income invested by this Institute and the component associations is a small part of the working capital consumed during the year as budgets are expended. The balance of revenue is derived from annual dues of the members.

The loss by taxation of half of this revenue will result in replacement measures reflected in the increase of annual dues. Since these are deductible items by members for income tax purposes, the proposal is considered to be self-defeating.

> It is recommended that The Royal Architectural Institute and its component provincial associations be classified with those non-profit associations or societies which will remain exempt from income tax on investment income.

5-3 Chapter 2, Section 2.24—Additional Elements of Income to be Subject to Tax

Fellowships, Scholarships, Bursaries and Research Grants

Funds provided by the Royal Architectural Institute of Canada for limited awards in this category were established years ago to encourage and support post-graduate studies by Canadian students of architecture.

They are derived from special investment income which is to be heavily taxed under the proposal in Section 5.54, Chapter 5.

The proposal to also tax the recipient constitutes a double levy that will drastically reduce the availability and value of these awards. As a result, a corresponding reduction of individual incentive can be anticipated at a time when just the opposite is desirable and when maximum encouragement to Canadian students should be offered.

> It is recommended that income from fellowships, scholarships, bursaries and research grants be exempt from Income Tax.

6. Recognition of Possible Benefits

Support if accorded to all proposals that may be of benefit to individuals, families, firms and their communities. The following are included in this category:

A. The proposed deduction for expenses incurred in earning employment income, although the maximum of $150.00 per year appears to be low. It is assumed that this will include professional association dues.

B. The proposal to introduce a general income tax ceiling of 50 per cent is supported on behalf of those individuals who might otherwise have been in higher tax brackets.

C. The proposals dealing in principle with general income averaging option is welcomed by architects whose annual income has traditionally been erratic and unstable and who have as a profession been pressing the government for years to introduce this option.

However the proposed and complicated averaging formula appears to place those with highly variable incomes in an unfavourable position in relation to those with more stable incomes and does not reflect a true averaging income over the five year period.

D. The proposals to broaden the tax base, to increase deductions allowed in

computing income and to increase personal exemptions for the taxation of individuals and families.

E. The proposals that are intended to curb the flagrant abuses of existing benefits and to halt the speculative exploitation of property in urban centers and rural areas.

7. Toward a Better Understanding

The Royal Architectural Institute of Canada records its appreciation for the opportunity to submit this brief on behalf of its members and the component associations.

It is felt that the Federal Government should welcome and initiate a thorough study of comparative costs to the taxpayer involved in the retention, housing and pensioning of large numbers of professional staff in various government departments, as opposed to a more extensive participation in public work by professional practitioners from the private sector.

The Institute shares the concern of its members from all sectors and would also welcome and be willing to assist in such a study.

The Institute is concerned that its members and associations as well as other professional groups may not have the opportunity to consider any amendments to the tax reform proposals that may result from their representations.

It is recommended that the Government should retain knowledgeable professionals from private practice and the public service to participate in the further development of taxation proposals that directly affect their professions.

APPENDIX 'A'

The Royal Architectural Institute of Canada with headquarters at 151 Slater Street, Ottawa, was founded in 1907 and incorporated in 1908. It is the national body of the profession representing a membership of 3,047 architects (January 1, 1970)—each of whom is registered in one or more of the nine provincial associations.

The President (1969-1970) is Mr. William G. Leithead, B.Arch., FRAIC, ARCA, of McCarter, Nairne & Partners, Vancouver. He heads a Council of fourteen members which includes five officers and nine councillors—one from each of the provincial associations.

The permanent staff in Ottawa includes the Director of Professional Services, the Executive Secretary, the Executive Assistant and a supporting secretarial staff of three. The annual operations of the Institute are financed by per capita dues of its members forwarded through the component associations.

The RAIC Standing Committees include Architectural Research, Architectural Education, Scholarships and Awards, Competitions, Legal Documents and a Committee of Presidents. Through special Joint Committees and Representatives, liaison is maintained with Federal Government Departments, Crown Corporations and other National and International Associations. Appointments to the recently formed Construction Industry Development Council include ten RAIC Members.

The Royal Architectural Institute of Canada holds membership in the International Union of Architects, the Commonwealth Association of Architects and recently the Pan American Federation of Associations of Architects.

The Institute maintains a Publications Board responsible for the official journal of the RAIC "Architecture Canada" which has had a wide circulation at home and abroad and in addition it published the "Architectural Directory Annual" and the Allied Arts Catalogue.

Architectural Directory Annual lists the following:

(a) Registered Architects in Canada, their addresses and telephone numbers.

(b) Architectural practices by Provinces.

(c) Professional, Business, Manufacturing and Trade Associations.

(d) The Building Construction Index of Products and Manufacturers.

The Allied Arts Catalogue illustrates examples of work in various media by artists who have either collaborated with architects, or contributed work directly to buildings. Two volumes have been published to date.

During the past year, due to the combination of increased postal rates and printing costs plus declining revenue, the Institute has been obliged to review and restructure its publication policy in order to provide continuing professional communication for its membership.

WAS/1p
March, 1970

APPENDIX 'B'

The Provincial Associations—1970

Architectural Institute of British Columbia, President: Mr. William R. Rhone, M.A., MRAIC.

Alberta Association of Architects, President: Mr. John McIntosh, B.Arch., MRAIC.

Saskatchewan Association of Architects, President: Mr. Clifford Wiens, B.Sc., MRAIC.

Manitoba Association of Architects, President: Mr. Gerald A. Libling, B.Arch, MRAIC.

Ontario Association of Architects, President: Mr. Michael G. Dixon, B.Arch., MRAIC.

Province of Quebec Association of Architects, President: Mr. Philip Freedlander, FRAIC.

Architects' Association of New Brunswick, President: Mr. John R. Disher, B.Arch., MRAIC.

Nova Scotia Association of Architects, President: Mr. E. Michael Byrne, B.Arch., MRAIC.

Newfoundland Association of Architects, President: Mr. T. Porteous Bolton, B.Arch., FRIBA, MRAIC.

APPENDIX "J"

Name: The Royal Architectural Institute of Canada

Subject: Certain Aspects of the White Paper Proposals

Analysis of Appendix "I" by Senior Advisor

This brief has been submitted by The Royal Architectural Institute of Canada.

The Institute, founded in 1907, is the national body of profession representing 3,047 architects, each of whom is registered in one or more of the nine provincial associations.

The brief itself comprises:

(1) An introduction. (Paragraphs 1, 2 and 3 on Pages 4 to 6).

(2) Proposals affecting Practice and Employment. (Paragraphs 4-1 to 4-5 on Pages 7 to 11).

(a) Accrual basis of computing taxable income.

(b) Entertainment and related expenses.

(c) Employment expenses—conventions.

(d) Depreciation—capital cost allowance.

(e) Closely-held corporations.

(3) Proposals affecting Architectural Organizations. (Paragraphs 5-1 to 5-3 on Pages 12 to 15).

(a) Employment and entertainment expenses.

(b) Investment income—clubs and other non-profit organizations.

(c) Fellowships, schloarships and research grants.

(4) Recognition of Possible Benefits. (Page 16).

Support is accorded to all proposals that may be of benefit to individuals, families, firms and their communities. The following are included in this category:

(a) The proposed deduction for expenses incurred in earning employment income, although the maximum of $150 per year appears to be low. It is assumed that this will include professional association dues.

(b) The proposal to introduce a general income tax ceiling of 50% is supported on behalf of those individuals who might otherwise have been in higher tax brackets.

(c) The proposals dealing in principle with general income averaging option is welcomed by architects whose annual income has traditionally been erratic and unstable and who have as a profession been pressing the government for years to introduce this option.

However the proposed and complicated averaging formula appears to place those with highly variable incomes in an unfavourable position in relation to those with more stable incomes and does not reflect a true averaging income over the five year period.

(d) The proposals to broaden the tax base, to increase deductions allowed in computing income and to increase personal exemptions for the taxation of individuals and families.

(e) The proposals that are intended to curb the flagrant abuses of existing benefits and to halt the speculative exploitation of property in urban centers and rural areas.

(5) Toward a Better Understanding. (Page 17).

It is recommended that the government should retain knowledgeable professionals from private practice and the public service to participate in the further development of taxation proposals that directly affect their professions.

The recommendations submitted to the Committee by the Institute are:

(1) That taxpayers in the professions continue to have the choice of reporting income either on the accrual basis or the cash basis. (Page 7).

(2) That architects in professional practice be allowed to deduct from income all expenses necessary for the maintenance and development of their practice including promotion, entertainment, club dues and travel. (Page 8).

(3) That for the professions, the cost of attending or sending employees to annual meetings, conventions, assemblies, profes-

sional seminars or workshops of an on-going educational nature should all be allowed as an operating expense—not subject to income tax. (Pages 9 and 13).

(4) That the existing system of computing capital cost allowance be retained. (Page 10).

(5) That the existing rate of corporate tax on the first $35,000 of income be retained. (Page 11).

(6) That the Royal Architectural Institute and the component provincial associations be classified with those non-profit associations or societies which will remain exempt from tax on investment income. (Page 14).

(7) That income from fellowships, scholarships, bursaries and research grants be exempt from tax. (Page 15).

(8) That the government should retain knowledgeable professionals from private practice and the public service to participate in the further development of taxation proposals that directly affect their professions. (Page 17).

The usual summary of present tax laws, White Paper proposals and principal points of the brief is attached.

Name: The Royal Architectural Institute of Canada

Date Brief Received:

Principal Subject: Accrual Basis of Computing Taxable Income

Present Tax Law

Section 85F of the Income Tax Act

The above section permits persons who carry on

(a) a profession, or

(b) farming

to elect to compute income on a cash basis, or to use the accrual basis.

Tax Reform Proposals

5.46 Generally taxpayers who are in business must compute their taxable income on what is known as the accrual basis. This means that a merchant must take into account the inventory of goods he has on hand, the amounts due to him from his customers, and the amounts he owes to his suppliers. An exception to this general rule has for many years been made for taxpayers in the professions (doctors, dentists, lawyers, chartered accountants, professional engineers, etc.). These taxpayers have been permitted to choose to report their income either on the accrual basis or on the cash basis—that is, they could omit the amounts due them from their clients and their "inventory" of unbilled time. Once a taxpayer chooses one basis he cannot switch to the other without the consent of the Minister. The government believes that the tax postponement permitted by this concession has given professionals an unwarranted advantage by comparison to the rest of Canadians, and it therefore proposes that professionals be required to use the accrual basis.

5.47 A problem would exist in switching professional taxpayers now on the cash basis over to the new system. This problem relates to their receivables and inventories at the date of the change over. For example, if 1971 is the first year of the new system, the problem would relate to the receivables and inventories as at the end of 1970. These amounts would not have been included in the taxpayer's 1970 income because they would not have been collected at that time. They would not be included in the 1971 income because they were earned before that time. To require that the entire amount be

Principal Points of Brief

Page 7 of Brief

This portion of the brief recommends that taxpayers in the professions continue to have the choice of reporting income either on the accrual basis or the cash basis.

Name: The Royal Architectural Institute of Canada

Date Brief Received:

Principal Subject: Accrual Basis of Computing Taxable Income

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	brought into 1971 income would impose an abnormal tax liability in that year. As a consequence, the government proposes that these taxpayers be entitled to bring these amounts into income over a number of years. Specifically, they would bring them into income as their total outstanding receivables and inventories are reduced. This amount would of course be in addition to the amount of their income computed on the accrual basis and would mean that they would be taxed on the greater of a cash-basis income or an accrual-basis income until they catch up to other Canadian businessmen.	

Name: The Royal Architectural Institute of Canada

Date Brief Received:

Principal Subject: Business Promotion Expenses

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act permits the deduction from income of reasonable amounts of business promotion expenses. Section 12-2 of the Income Tax Act permits the tax collector to restrict claims for unreasonably large amounts of expense.	5.9 Although the government believes that provision should be made for the deduction of legitimate business expenses that have not previously been deductible, it also believes that the present system permits deduction of certain types of expenses which taxpayers should be expected to meet out of tax-paid income. Consequently it is proposed that the Income Tax Act specifically deny deduction for entertainment expenses, the costs of attending or sending employees to conventions, and the cost of dues for membership in social or recreational clubs. This provision would not prohibit the expenditure of funds for these purposes, but it would ensure that taxpayers who wish to make such expenditures would do so out of after-tax dollars. 5.10 Under the system outlined in Chapter 4, whereby shareholders are given credit for the tax paid by their corporations, merely denying a deduction for this type of expenditure is not sufficient. Although the denial of the deduction would mean that the corporation pays extra tax, the shareholders of the corporation would receive credit for the extra tax paid. Therefore, it is necessary to provide further that, in the case of corporate taxpayers, taxes due because of the non-deductibility of these expenditures would not be creditable.	Page 8 of Brief This portion of the brief recommends that all architects be allowed to deduct from income those expenses necessary for the maintenance and development of their professional practice, including promotion, entertainment, club dues, travel and the like.

Name: The Royal Architectural Institute of Canada

Date Brief Received:

Principal Subject: Cost of Attending Conventions

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 11-1-(ia) of the Income Tax Act and Information Bulletin No. 38 of March 23, 1968 These sections permit a taxpayer who is carrying on a business or practising a profession to deduct from income the costs of attending not more than two professional conventions in a year.	2.11 The government has considered this issue at length. It proposes two sets of measures to remedy the disparity. First, in regard to those in business and the professions, and to certain types of benefits granted by employers to senior employees, it intends to set more rigorous limits to check "expense account living." The costs of attending conventions and belonging to clubs would no longer be permitted as a charge in determining business income. The costs of yachts, hunting and fishing lodges or camps, amounts spent for tickets for games and performances, and costs of entertainment would also be excluded. Owners or employees of a business having a car or aircraft available to them for their personal use, including travel to and from home, would have to pay the business a minimum stand-by charge, or have a corresponding amount added to their personal income for tax purposes.	Page 9 of Brief This portion of the brief recommends that architects be allowed to deduct from income the expenses of attending the annual meeting of their provincial association and annual assembly of their national institution as provided by existing legislation.

Name: The Royal Architectural Institute of Canada

Date Brief Received:

Principal Subject: Capital Cost Allowances

Present Tax Law	Tax Reform Proposals	Principal Points of Briefs
Under the present Income Tax Act, taxpayers are permitted to claim annual capital cost allowances in respect of depreciable property owned by them.	5.14 The system has without doubt proven easy to comply with, and has caused far fewer difficulties between taxpayer and taxgatherer than the more usual "straight-line" system that preceded it in 1948 and earlier years. One of the reasons that it works so well may be because, on balance, the rates tend to be on the generous side. This generosity has acted as an incentive to taxpayers to modernize and improve their business facilities, but naturally at some cost in government revenue. The royal commission did not recommend reductions in depreciation rates. Perhaps for that reason, the rates were not generally an issue in the public debate on tax reform that has taken place over the past two years. Nevertheless some have suggested that they are too generous, and the government believes that after 20 years of the system it is time for a review. However, depreciation is an important aspect of the tax system and taxpayers should have an opportunity to put forward their views and experience before major changes are considered. Therefore, the government intends in due course to invite briefs on the system and rates of capital cost allowance. 5.16 Many taxpayers who would otherwise be in quite high tax brackets have become landlords, and have been able to reduce or eliminate the tax on their other income by claiming the maximum depreciation on their buildings. Ideally this early generosity should be offset by lower depreciation deductions in later years, or by recapture of the extra depreciation on sale. However, if the taxpayer buys additional buildings—and with the relatively low down payments required, this can	Page 10 of Brief This portion of the brief recommends that the exising system of computing capital cost allowance be retained.

Name: The Royal Architectural Institute of Canada

Date Brief Received:

Principal Subject: Capital Cost Allowances

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	often be done out of the tax savings alone—he can postpone almost indefinitely the day when his total depreciation deductions will drop below average. Moreover, since most of the buildings concerned are in the same class, a taxpayer who sells a building can avoid recapture of the proceeds by investing them in another building. Finally, if the taxpayer continues this process throughout his life, the tax postponed becomes tax saved forever. When a taxpayer dies, excess depreciation is not recaptured, and the person who inherits the buildings is entitled to depreciate the full fair market value of the buildings, no matter what net book value his predecessor had.	
	5.17 The government proposes to close this loophole in three ways. First, as mentioned in Chapter 3, a person who inherits property would for tax purposes inherit the tax cost of that property to the deceased. In this case, that would mean that the inheritor starts with the same base for depreciation as the deceased had when he died. Second, a taxpayer would be prohibited from deducting from other income a loss from holding property if that loss is created by capital cost allowance. (It is also proposed that the same restriction be placed on the deductibility of losses arising from holding property if those losses are created by a deduction of interest or property taxes. Otherwise taxpayers could reduce or eliminate the tax on their current incomes by holding large amounts of speculative property.) Finally, it is proposed that a separate depreciation class be created for each rental building that costs $50,000 or more. This would mean that there	

would be a day of reckoning for the owner of each large building. As each such building is sold the taxpayer would bring back into income the amount by which depreciation deducted for tax purposes exceeds the depreciation actually suffered, or conversely he would get a deduction for tax purposes immediately if he has in fact suffered greater depreciation than he has been allowed for tax purposes.

5.18 Because the depreciation rates are based on averages, they sometimes turn out to be inadequate. Indeed, as the royal commission pointed out, there are instances in which the net book value of a class of assets becomes greater than the cost of the assets that the taxpayer has on hand at the time. This arises, of course, because the depreciation he has been permitted was not as great as the actual depreciation suffered on some of the assets which he has since sold or scrapped. This problem would disappear in the case of rental buildings which cost more than $50,000 as explained in the previous paragraph. However, it would remain for other assets. Consequently the government proposes that taxpayers be permitted at any time to write a class of assets down to the aggregate cost of the assets of that type still on hand.

Name: The Royal Architectural Institute of Canada

Date Brief Received:

Principal Subject: Lower Rate of Tax on first $35,000 of Taxable Income

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
This subject has been dealt with in Special Study No. 5, Taxation of Small Businesses, and is not repeated here.		Page 11 of Brief This portion of the brief recommends that the existing rate of tax on the first $35,000 of taxable income of corporations be retained.

Principal Subject: Cost of Attending Conventions

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 11-1-(ia) of the Income Tax Act and Information Bulletin No. 38 of March 31, 1968 These sections permit a taxpayer who is carrying on a business or practising a profession to deduct from income the costs of attending not more than two professional conventions in a year.	2.11 The government has considered this issue at length. It proposes two sets of measures to remedy the disparity. First, in regard to those in business and the professions, and to certain types of benefits granted by employers to senior employees, it intends to set more rigorous limits to check "expense account living." The costs of attending conventions and belonging to clubs would no longer be permitted as a charge in determining business income. The costs of yachts, hunting and fishing lodges or camps, amounts spent for tickets for games and performances, and costs of entertainment would also be excluded. Owners or employees of a business having a car or aircraft available to them for their personal use, including travel to and from home, would have to pay the business a minimum stand-by charge, or have a corresponding amount added to their personal income for tax purposes.	Pages 12 and 13 of Brief This portion of the brief recommends that the cost of attending, or sending employees to attend, annual meetings, conventions or conferences of professional organizations be allowed as an expense—not subject to income tax.

Principal Subject: Taxation of Investment Income of Institute

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 62-1-i of the Income Tax Act This section exempts from annual income taxes, the income of a club, society or association organized and operated for any purpose other than profit, no part of whose income is available for the personal benefit of any member thereof.	4.60 The government does not proose a refund to pension plans and other tax-free entities of the corporate tax paid by the corporations from which they receive their dividends. It considers that tax-free status of the investment income of the pension plan, including capital gains, is sufficient tax concession to these entities. 5.54 The present law contains a provision—section 62(1)(i)—that exempts from income tax social, recreational and service clubs, societies and associations which operate on a non-profit basis. (This provision does not cover registered charities which are exempted under other paragraphs.) The government does not propose to change the exempt status of the basic functions of these organizations, but when they accumulate investment portfolios, it believes that the investment income therefrom should bear income tax. Therefore it is proposed that the investment income of organizations which are covered by section 62(1)(i) be subjected to the corporation tax.	Page 14 of Brief This portion of the brief recommends that the Royal Architectural Institute and its component provincial associations be classified with those non-profit associations or societies which will remain exempt from income tax on investment income.

Principal Subject: Taxation of Scholarships, Fellowships, Research Grants and the like.

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
At the present time the amounts of most scholarships and other similar grants do not have to be included in the income of the recipient.	1.37 It is also proposed, in fairness to other taxpayers, that fellowships, research grants, scholarships and bursaries be treated as taxable income but subject to the deduction for tuition fees and costs incurred for research. Undergraduates would seldom need to pay tax because few scholarships and bursaries are larger than the new personal exemptions plus the fees that may be deducted from students' incomes. But if students have other income, there is no reason why they should not be taxed like other Canadians.	Page 15 of Brief This portion of the brief recommends that income from fellowships, scholarships and the like be exempt from tax.

Name: The Royal Architectural Institute of Canada

Date Brief Received:

Principal Subject: Taxation of Scholarships, Fellowships, Research Grants and the like.

Tax Reform Proposals

2.24 Until now most fellowships, scholarships, bursaries and research grants not related to services have been treated as exempt from tax. There seems no valid reason for continuing such exemption. Post-graduate students and research workers are, in effect, professional workers and should pay tax as others, after allowances for tuition fees and for research expenses properly deductible from research grants. Payments to undergraduates normally fall well within the personal exemptions, after deducting tuition fees. Where they exceed exemptions or where the student has other income, he should pay tax just as other Canadians do.

Principal Subject: Employment Expense

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act permits no such deduction.	1.32 The government has examined the deductions individuals may claim for various costs they incur, as well as differences in treatment between taxpayers who are employed and those who carry on a business or profession. The royal commission said many employees have been over-taxed because they have been denied the deduction of almost all expenses incurred in earning wages and salaries. But millions of taxpayers are involved, and a very wide range of expenses could be related to earning their employment income. These taxpayers do not keep detailed records. The government has found no practical way to permit employees to deduct actual costs as do those carrying on a profession or other business. We propose to provide	Page 16, Paragraph A of Brief This portion of the brief recommends this proposal, although it suggests that the amount of $150 per annum appears low. It assumes this deduction will include professional association dues.

employees with a general deduction to cover expenses, in addition to certain specified deductions. The amount would be 3 per cent of employment income, up to a total of $150 a year. This could benefit more than 6,500,000 persons, the great majority of them earning less than $10,000 a year.

2.12 As its second measure, the government proposes to make more provision in the law for the expenses legitimately incurred in earning wages or salaries. However, it has reached the conclusion that claims for expenses on the broad basis suggested by the commission would either impose record-keeping on millions of employees or deny them the ability to submit acceptable claims. It would also produce an impossible processing task in tax administration with inevitable long delays in making refunds. Consequently the government proposes that general limits be retained on expenses that can be deducted from employment income but that a general deduction be provided and somewhat greater recognition given to special situations where employees have to live for a period of time at a work site away from home.

2.13 It is proposed to allow a general deduction for employment expenses, similar to the option proposed by the commission but with a lower maximum. The government believes these expenses are not generally as high as implied by the commission. It would be costly, and inequitable to others, to permit substantially more to be deducted by means of a formula than was normal in typical cases. Consequently it is proposed that the general deduction allowed for expenses incurred in earning employment income be 3 per cent of gross employment income up to a maximum of $150 per year.

Name: The Royal Architectural Institute of Canada

Date Brief Received:

Principal Subject: Maximum Federal and Provincial Income Tax Rate of 50%.

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act contains no such limitation.	2.42 The government has concluded that as the taxation of capital gains becomes fully effective, and transitional measures in the new system have ceased to be important, top rates of combined federal and provincial personal income tax should be reduced to 50 per cent. The top rates should gradually be reduced from the present levels, in four instalments commencing in the second year in which the new system applies. 2.43 After this change becomes fully effective the rates of tax on those who now report taxable income in excess of $40,000 would be lower than at present but as result of proposed changes in the taxation of corporations and corporate distributions, restrictions on expense deductions and the inclusion of gains, the amount they have to report as income for tax purposes would be substantially increased. The taxes on capital gains would be paid mainly by those in the higher brackets and after the first few years should produce hundreds of millions of dollars. This increase in the tax base is a far better way of taxing the wealthy than having ostentatiously high rates on an incomplete tax base.	Page 16, Paragraph B of Brief This portion of the brief supports this proposal.

Principal Subject: Averaging of Income

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act contains no averaging formula comparable to that contained in the White Paper proposals.	2.55 The government has reached the view that a general averaging formula should be available to all individual taxpayers. However, it proposes a much simpler and more automatic system than the royal commission did. Averaging would introduce new complications for the taxpayer, and new need	Page 16, Paragraph C of Brief This portion of the brief supports the White Paper proposal that an averaging of income formula be adopted.

for keeping records. Moreover, the system proposed by the commission would confront the taxpayer with difficult choices, and the possibility of choosing a period that would later prove to be against his own interest. The proposed simpler method can be applied automatically by the central tax assessment computer, using the information for previous years stored in its memory. Moreover, it would work smoothly and fairly even when tax rates change. It should also be noted that averaging options can be very expensive in terms of revenue, particularly at a time when incomes are growing rapidly, and there must be safeguards against giving the benefits of averaging to what are simply growing incomes.

2.56 The method proposed is as follows: when the income in the taxation year exceeds the average of the taxpayer's income in the preceding four years by more than one-third, the excess income would be taxed as though it were subject to a graduated rate schedule in which the income brackets to which each rate applied were five times as wide as normal. The formula is necessarily complicated but this would not concern taxpayers because it can be applied on their behalf. Tables 11 and 12 show the application of the formula in more detail.

2.58 It would not be possible to bring the general averaging arrangement into effect immediately. It would be necessary to have the records of assessed income for previous years for all or nearly all taxpayers before the system could be fairly used. Until this accumulation of information reaches five years it would be necessary to use a shorter series of years, with a lower "threshold level".

However, it suggests that the proposed formula is overly-complicated and does not reflect a true averaging income over the five year period.

Name: The Royal Architectural Institute of Canada

Date Brief Received:

Principal Subject: Averaging of Income

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	2.59 A second and more serious practical problem is whether years in which there is no taxable income for one reason or another should be counted for averaging, and whether years before such a year of no income should be used. It seems unfair to permit a taxpayer to include in averaging any years in which he or she is claimed as a dependant for purposes of the married exemption. The same is true of students at school or university. Counting such years of no income, or income below the exemption limit, might well reduce tax for several years on people who have chosen to be outside the labour market and in respect of whom dependants' deductions have been granted. It is therefore proposed that a married person may use for averaging only an unbroken series of years after being claimed as a dependant by his or her marriage partner. A person under 25 years of age could use only an unbroken series of years since the last year in which he had no tax to pay. These rules are not wholly satisfactory, but no simple and practical alternative has been found. Those prevented by such rules from using more than, say, two previous years for averaging might be permitted to assume an arbitrary income of $5,000 per year in the years excluded.	

Principal Subject: Increased Personal Exemptions

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	1.25 To remove or reduce taxes on lower-income taxpayers the government proposes to increase the basic personal exemption for a single person to $1,400 from $1,000 and for a married couple to	Page 16, Paragraph D of Brief This portion of the brief supports the following White Paper proposals:

$2,800 from $2,000. The basic standard deduction available in lieu of deductions for charitable donations and medical expenses would remain at $100. Consequently those taxable as single persons with income under $1,500 would have no tax to pay and those taxable as married would have no tax to pay if their incomes were under $2,900. These new exemptions would be much higher than those in other countries as shown in Table 3 page 26.

1.32 The government has examined the deductions individuals may claim for various costs they incur, as well as differences in treatment between taxpayers who are employed and those who carry on a business or profession. The royal commission said many employees have been over-taxed because they have been denied the deduction of almost all expenses incurred in earning wages and salaries. But millions of taxpayers are involved, and a very wide range of expenses could be related to earning their employment income. These taxpayers do not keep detailed records. The government has found no pratical way to permit employees to deduct actual costs as do those carrying on a profession or other business. We propose to provide employees with a general deduction to cover expenses, in addition to certain specified deductions. The amount would be 3 per cent of employment income, up to a total of $150 a year. This could benefit more than 6,500,000 persons, the great majority of them earning less than $10,000 a year.

1.33 Costs of looking after young children when both parents are working, or when there is only one parent and that parent is working, would be allowed as a deduction subject to certain conditions. This new plan is intended primarily to benefit mothers who need to work to support their families, and would be in addition to the normal exemption for children. The maximum expenses allowed would be the lower of $500 per child under age 14 or $2,000 per family.

(1) Broadening the tax base.

(2) Increasing deductions allowed in computing income.

(3) Increasing personal exemptions.

Name: The Royal Architectural Institute of Canada

Date Brief Received:

Principal Subject: Increased Personal Exemptions

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	1.36 The government has decided that it would make the tax system fairer if the treatment of unemployment insurance were changed to permit workers to deduct their contributions to the fund and to require them to pay tax on benefits received. Many of the benefits are received by employees with average or higher than average incomes who are unemployed for relatively short periods, and whose annual incomes equal or exceed the annual earnings of others. The higher their incomes the greater the tax benefit. It is fairer to tax them on this part of their income, as long as we permit all employees to deduct their contributions. Anyone on unemployment insurance benefits for most of the year is likely to pay little or no tax. 2.4 These factors led the government to propose an increase in personal exemptions to $1,400 from $1,000 for single taxpayers (or married taxpayers filing as single) and to $2,800 from $2,000 for married taxpayers filing as such. The deduction for children and other dependants would remain the same, although some of the conditions relating to them would be changed as noted below. These new exemptions plus the $100 standard deduction, which would be continued, would mean that those entitled to the married exemption would be exempt up to an income of $2,900 and single persons to $1,500. These increases would free from income tax about 750,000 persons now subject to tax. 2.15 A deduction would be allowed for the expense taxpayers often must incur when they move from one job to another. The expenses of moving from one residence to another in these circumstances would be deductible provided that the taxpayer	

moves to a location at least 10 miles closer to his new job. The deduction would be permitted only from the income earned from working in the new locality.

2.17 It is necessary to reduce the extra exemption for married status where the wife or husband of the taxpayer has an income and to reduce the deduction for children or other dependants where they have an income of their own. This should be done gradually by reference to the income of the dependant so there is no abrupt dividing line causing unfairness between those just over and just under it. For this purpose it is proposed that the additional exemption of $1,400 for a married man be reduced by $1 for every $1 that his wife's income exceeds $100, so that he would be taxed as a single person when her income is just enough to make her taxable. The same rule would apply where a wife supports her husband. In the case of children under 16, for whom the deduction is $300 (and for whom family allowances are normally payable) it is proposed that the parent's deduction be reduced by $1 for every $2 of income of the child in excess of $900, so that the deduction would disappear when the child is taxable on his own income. For older children and other dependants, for whom the deduction is $550, the taxpayer's deduction would be reduced by $1 for every $1 that the dependant's income exceeds $950, so that this deduction too would disappear when the "dependant" becomes taxable. The amount of $950 is used in the present rules for dependants but the deduction is abruptly cut off when income exceeds this level. In determining the income of a student, for this purpose as well as for his own taxable income, tuition fees may be deducted.

2.18 An additional amount of $500 is currently added to the personal exemption for a person over 70, or for a blind person, or for a person confined to a wheelchair. Although the royal commission

Name: The Royal Architectural Institute of Canada

Date Brief Received:

Principal Subject: Increased Personal Exemptions

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	recommended that this be cancelled, it is proposed to continue this additional exemption for such taxpayers on compassionate grounds. It can be argued that this is not the best way to assist the incapacitated or the elderly but most of the incapacitated benefiting from this provision have relatively small incomes, and taxpayers' needs tend to increase with age. 2.19 It is proposed to continue existing deductions and arrangements for charitable donations. Important improvement have been made in these arrangements in recent years. We propose to add national amateur athletic associations as prescribed by regulation to the list of eligible charitable organizations.	

Principal Subject: Proposals intended to curb flagrant abuses of existing benefits and to halt exploitation of property in urban centers and rural areas

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		Page 16, Paragraph E of Brief This portion of the brief commends the White Paper proposals designed (a) to curb the flagrant abuses of existing benefits, and (b) to halt the speculative exploitation of property in urban centers and rural areas.

Principal Subject: Co-Operation with Department of Finance.

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
No provision exists in the present Income Tax Act respecting this proposal.	No relevant proposal.	Page 17 of Brief This portion of the brief recommends that the Government of Canada should retain knowledgeable professionals from private practice and public service to participate in further development of taxation proposals that directly affect their professions.

Queen's Printer for Canada, Ottawa, 1970

Second Session—Twenty-eighth Parliament
1969-70

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE
ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 15

THURSDAY, APRIL 9th, 1970

Ninth Proceedings on the Government White Paper,
entitled:
"PROPOSALS FOR TAX REFORM"

WITNESSES:

Canadian Labour Congress: Donald MacDonald, President; W. R. Bell, Director of Research; W. Dodge, Secretary-Treasurer and A. Andras, Director of Legislation. *Personal Submission:* Harry R. Jackman, Q.C.

APPENDICES:

"A"—Brief from the Canadian Labour Congress.

"B"—Year-end Indices of Leading Stock Markets, 1960-1970, submitted by Mr. Jackman.

21819—1

THE STANDING COMMITTEE ON

BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aseltine	Desruisseaux	Kinley
Beaubien	Everett	Lang
Benidickson	Gélinas	Leonard
Blois	Giguère	Macnaughton
Burchill	Grosart	Molson
Carter	Haig	Phillips (*Rigaud*)
Choquette	Hayden	Walker
Connolly (*Ottawa West*)	Hays	Welch
Cook	Hollett	White
Croll	Isnor	Willis—(30)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

"With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intituled: "Proposals for Tax Reform", prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

"With leave of the Senate,

The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Hayden:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

21819—1½

MINUTES OF PROCEEDINGS

THURSDAY, April 9th, 1970.
(20)

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to further consider:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Hayden (*Chairman*), Beaubien, Blois, Burchill, Carter, Connolly (Ottawa West), Cook, Flynn, Gelinas, Haig, Hays, Hollett, Isnor, Lang, Molson and Welch.—(16).

Present, but not of the Committee: The Honourable Senators Aird, Laird, Sullivan and Urquhart—(4).

In attendance: Arthur W. Gilmour, Senior Advisor; Alan J. Irving, Legal Advisor and Roland B. Breton, Executive-Secretary.

The following witnesses were heard:

Canadian Labour Congress:

Donald MacDonald, President;
R. Bell, Director of Research;
W. Dodge, Secretary-Treasurer and
A. Andars, Director of Legislation.

Personal Submission:
Harry R. Jackman, Q.C.

Ordered,—That the brief submitted by the Canadian Labour Congress be printed as Apendix "A" to these proceedings and the chart supplied by Mr. Jackman as Appendix "B".

At 12:00 Noon the Committee adjourned to the call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Ottawa, Thursday, April 9, 1970.

The Standing Senate Committee on Banking, Trade and Commerce, met this day at 9.00 a.m. to give further consideration to the White Paper entitled "Proposals for Tax Reform".

Senator Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: Honourable senators, we have as our first submission this morning a brief from the Canadian Labour Congress, and I understand that Mr. MacDonald, the President, will be leading the discussion.

Mr. D. MacDonald, President, Canadian Labour Congress: Thank you, Mr. Chairman. On my right is the Secretary-Treasurer of the Congress, Mr. William Dodge; and next to him is Mr. Andy Andras, the Director of our Legislative and Government Employees' Department.

The Chairman: You can proceed in whichever way you like, either by reading your brief or, if you have a summary, by reading it. After that you will be open to questions, and if you feel at any time you wish to call on any member of the panel, just do so.

Mr. MacDonald: Honourable senators, first of all I should express our appreciation for this opportunity to appear before the committee and express our views with respect to the White Paper.

We very much regret the fact that the pressures of other matters have made it impossible for us to submit our memorandum to the committee as early as we would have liked. We did get it in some days ago, however, and we do hope that the honourable members of the committee have had the opportunity of reading it. We propose this morning merely to summarize it, although it in itself is not overly lengthy. As you yourself have suggested, sir, any questions that are directed to me may be referred to the people who are associated with me here, my colleagues.

Incidentally, we have now been joined by Mr. Russell Bell, who is our Director of Research.

In our summary what we say is that while we disagree in a number of respects with the White Paper, as we have indicated in our main submission, we believe that the White Paper, in general, has made a significant contribution in both exposing the highly unequitable tax system which we now have and in suggesting ways in which to make the tax system more equitable.

The basic philosophy underlying our approach to any discussion of taxes, whether these taxes are levied at the federal, provincial or municipal level, is that the distribution of the burden of all taxes, wherever possible, should be based upon the ability to pay—words which appear in the Carter Commission's report, and which we are glad to note appear in the White Paper.

We are well aware of highly organized campaigns the object of which is to discredit the progressive proposals contained in the White Paper. Needless to add, we dissociate ourselves from these groups who obviously oppose any move to bring about a more equitable tax system. We agree with the main points to be met, as set out in the White Paper. However, as we have indicated in our submission, we believe that the proposals in the White Paper fall short of effectively meeting some of these points.

These points are that Canadians in the low income tax bracket face a heavy total tax burden. In recent years sales taxes and property taxes have been increased substantially. Where changes in the income tax can provide further relief, it must be given to those with lower incomes.

Secondly, important forms of income benefits escape taxation.

Thirdly, tax can be avoided under the present law by clever devices. Wage earners are unable to deduct many legitimate expenses from taxable income, and new deductions are needed to benefit employees and working mothers. Corporations also are taxed in ways that are open to abuse.

Finally, the mineral industries enjoy special tax benefits that have existed for many years, but that are unnecessarily costly and inefficient.

We believe that these are highly commendable points in that they effectively expose many of the inequities and inefficiencies inherent in our present tax system. However—and we wish to emphasize this as strongly as possible—we do not believe that the proposals in the White Paper will significantly alleviate the tax burden which now rests on those in the lower income brackets, until they come to grips with the most inequitable aspect of our tax system, namely, the general sales taxes. The White Paper is quite candid in recognizing the highly inequitable and regressive nature of these taxes.

The White Paper also makes the point, in which we fully concur, that more than any other tax the personal income tax can be carefully adjusted to the income of the individual, and the circumstances which affect this ability to pay, such as family responsibilities and unusual expenditures or expense obligations. It should be given priority in the tax reform program. It is precisely because we agree with this policy that we find so baffling the statement immediately following the above words:

> Reform of the sales tax is less urgent and can be undertaken after action on the proposals in this paper.

We believe that the time is now at hand to start making a major shift away from these regressive taxes, and this, unfortunately, the White Paper fails to do.

We believe that the proposal in the White Paper to remove or reduce taxes for certain lower income taxpayers by increasing the basic personal exemptions does not mitigate the inequality of our overall tax system, since the raising of exemptions applies to all taxpayers irrespective of ability to pay.

Furthermore, while the proposed improvements in the personal income tax would lead to elimination or reduction of taxes for the lower income brackets, the fact is that these tax savings are extremely small.

We also find it difficult from the standpoint of equality to understand why the White Paper proposes tax increases for those in the middle income brackets, but fails to provide for proportionate increases for those with higher incomes. We are not satisfied with the explanation given for this in the White Paper, for the reason that we have stated.

We commend the proposal in the White Paper which would abolish the present double tax rate on corporate income, for the reasons stated in both the Carter Commission's report and the White Paper. We strongly endorse the position taken by the Government to tax capital gains, a step which we believe is long overdue, and a step which we believe is indispensable to making the overall tax system more equitable.

We would like, however, better clarification of the distinction drawn between closely-held corporations and widely-held corporations, for the purpose of taxing gains on shares.

We welcome the proposal to permit the deduction of child care expenses by working parents. In the words of the White Paper, such expenses constitute a real cost of earning income.

We are happy to note that the Government is now prepared to recognize the principle that employee expenses should be deductible for tax purposes, as has long been the case for business and professional expenses. However, we believe that the proposed three per cent deduction, with a maximum of $150, for employment expenses falls short of what is required by many categories of workers whose outlay is much greater for such items as special clothing and replacement of tools. The Carter Commission, in our view, was much more realistic in recommending a maximum deduction of $500 for this purpose.

That is a summary of our views, Mr. Chairman.

The Chairman: Thank you, Mr. MacDonald. Gentlemen, the witnesses are now ready to deal with your questions.

Senator Carter: I should like to ask Mr. MacDonald to clarify his position on the sales tax. Does he recommend its complete elimination?

Mr. R. Bell, Director of Research, Canadian Labour Congress: I think, sir, that it is not possible to eliminate the sales tax altogether. There are very difficult problems involved in this whole issue of the sales tax which were very clearly recognized in the report of the Carter Commission, but it seems to us that the time has come to attempt to make a fairly significant shift away from the sales taxes because they are so highly regressive. The Carter Commission's report, as you are undoubtedly well aware, suggested that a feasible alternative to the present system would be a retail sales tax of 7 per cent. This may pose certain problems in so far as the provinces are concerned, but it seems to us that until there is some major shift away from the sales taxes, which are very highly regressive taxes, it is virtually impossible to bring about an equitable tax system.

In our submission we did not go into ways and means by which this particular problem may be solved, but we would hope that the committee itself, as a matter of fact, and eventually the Government, will undertake very thorough studies to see what can be done to get away from this very highly regressive form of taxation.

Senator Carter: Are you advocating, then, a reduction in the sales tax to begin with? You say "a shift away from it". What do you mean by that? You have either to reduce or substitute.

Mr. Bell: Exactly. We mean shifting away with a reduction, and hopefully a significant reduction, in the present sales tax.

Senator Beaubien: In the Province of Quebec we pay a federal sales tax of 12 per cent, and then we pay a provincial sales tax of 8 per cent. Where are you going to put your 7 per cent, or where are you doing your shifting away?

Mr. Bell: The Carter Commission indicated that this was quite feasible.

The Chairman: Mr. Bell, I gather that what you meant to convey was that there should be substituted for the present federal sales tax a new tax on the retail price of 7 per cent; is that right?

Mr. Bell: Well, I indicated that this was recommendation of the Carter Commission. This has the advantage, of course, of avoiding the pyramiding effects of the present federal sales tax.

Senator Connolly (Ottawa West): Because it is not levied at the wholesale level?

Mr. Bell: Precisely, because it is not levied at the wholesale level. The present tax, of course, is levied at the manufacturer's level.

The Chairman: Is there any significance in the relationship of the present sales tax to your proposed figure of 7 per cent? Would the difference between the basis for the present sales tax and a sales tax which would have its basis in the retail price represent factors that are added to the price which the consumer pays because the levying starts so far back?

Mr. Bell: Under the present federal sales tax the levying, of course, is at the manufacturer's level. The consumer does not actually pay 12 per cent. He pays more than 12 per cent because of the pyramiding effects that take place during the various stages of distribution.

Senator Connolly (Ottawa West): Do you suggest that perhaps the revenue might not be affected if it were levied at the retail rather than the manufacturer's level? We have to be realistic about the fact that government has to have the revenue. Therefore the fact is if you do not get it from one place you have to get it from another. Assuming they need all the revenue obtained from the sales tax, do you think that your proposal would allow the sales tax to be reduced and still provide the revenue, you being an economist?

Mr. Bell: No, the sales tax, if it were imposed at the retail level at 7 per cent, as suggested by the Carter Report, would obviously reduce the total government revenue. It would have to be made up elsewhere. The White Paper itself spells out very clearly a principle to which we would certainly subscribe. It spells out a very obvious fact, that the only tax that can be made porgressive is the personal income tax. As the White Paper itself indicates, the personal income tax is based on graduated rates and it can be made to accord with a person's ability to pay, and so on. The important principle here is that as governments collect more and more revenue through taxes other than the personal income tax, then the tendency will definitely be towards regressive taxation.

Senator Connolly (Ottawa West): The 50 per cent ceiling on the income tax as now

proposed really is a negation of the general principle of ability to pay.

Mr. Bell: Yes, we state that in our brief. We just do not find the explanation given in the White Paper for the ceiling of 50 per cent very satisfactory. There is an assumption in that 50 per cent ceiling which we just do not accept.

Senator Carter: Is it your theory that if we reduce the sales tax and the manufacturer's tax that it would automatically help the poor, lower income group by reducing the cost of the articles they purchase?

Mr. Bell: Very definitely. There is no question at all about that.

Senator Carter: Can you corroborate that from the experience when the tax was removed from drugs? Did that materially reduce the price of drugs?

The Chairman: Do you mean as a fact did the market react?

Senator Carter: Yes.

The Chairman: I do not think it did.

Mr. Bell: No, there have been various studies carried out with regard to the sales tax and how it affects lower income people. It is a highly regressive tax because it is proportionate rather than progressive. The very fact that the sales tax covers virtually all goods with the excep ion of food, which means in effect that people at lower income brackets who have got to produce the same kinds of goods as you and I, senator, and the fact that they are subjected to this very high tax, which is more than the actual 12 per cent that is levied at the manufacturer's level, indicates clearly that it hits these people hard. There is no question about that. As a matter of fact, the White Paper itself is clear in indicating that.

Senator Molson: How does it change the impact if instead of paying for an article that has 12 per cent tax on it at the manufacturer's level, there is no tax there, and a retail sales tax is levied? How does that change the impact between the well-to-do and the poorer people whom we are discussing? They are still going to pay the tax, presumably, unless it is removed.

Mr. Bell: Do you mean if the present sales tax were eliminated?

Senator Molson: And the retail tax applied, as you suggest. You have got to remove the tax or reduce it to help the smaller people.

Mr. Bell: The Carter Report suggested a reduction of the sales tax to 7 per cent. That would be a very significant reduction.

Senator Beaubien: Yes, but it would be 7 per cent at a different level. It would be 12 per cent at the manufacturer's level, but at the retail level there is, of course, 30 per cent added, so you are paying 7 per cent of 130 per cent instead of 12 per cent of 100 per cent.

Mr. Bell: Yes, but under the present system the 12 per cent is imposed at the manufacturer's level. It has a pyramiding effect through all levels of distribution because of markups which take place. So instead of 12 per cent it could be 15, 16 or 17 per cent. The Carter Report's recommendation was that the sales tax be imposed at the retail level at 7 per cent. That is an actual 7 per cent; there are no markups on that at all.

Senator Beaubien: Yes, but the markups and costs have taken place before the tax is applied.

The Chairman: Except that the markups occur at the different levels of trade. If they are applied to reach a price at the end that includes the sales tax it would make your calculation on a higher level and the consumer who buys at the retail price is paying more than the 12 per cent of the manufacturer's price.

Senator Beaubien: Sure he is, but Mr. Chairman, if you take all the steps in between some articles are marked up 100 per cent, so the tax at 7 per cent is going to apply to the 200 per cent of the cost of the article. If there is any saving to the public it is a reduction to the government revenue.

Senator Molson: If the government is trying to attain a certain volume of tax revenue I do not see how the tax system can be made more equitable. This is the word we are using and a very good one too. I do not see how it can be made more equitable by changing the tax from the present manufacturer's level to the retail level. I would say a reduction in sales tax would be very helpful, but I do not see that the change of impact makes a great deal of difference if the tax is going to exist at a later stage.

Mr. Bell: There is a very considerable difference between that tax and sales tax at the manufacturer level and at the retail level, as the Chairman just indicated.

Senator Connolly (Ottawa West): In dollars.

Mr. Bell: The actual cost of that item paid by the consumer.

Senator Connolly (Ottawa West): What we are really saying is that what is required is a reduction in that form of tax.

Mr. Bell: Yes.

Senator Connolly (Ottawa West): That is really it. It might be the best way to do it through shifting it to retail. The message is that what is wanted is a reduction in the sales tax.

Mr. Bell: Yes.

Senator Hays: Have you any figures of the breakdown showing what a man earning $8,000 would pay in real property tax, sales tax and so on?

Mr. Bell: No, we do not.

Senator Hays: Is it possible to get those figures?

Mr. Bell: As a matter of fact, no survey has been undertaken. The Dominion Bureau of Statistics would be the appropriate body to undertake that kind of survey but to my knowledge no such survey has been undertaken to ascertain those facts.

Senator Hays: You mention real property and sales tax. In, for example, the City of Toronto, I think the distribution of real property tax would be 50 per cent for education and the balance for other municipal services. In some cities it can go as high as two-thirds for education and one-third for other municipal costs. Would it be possible to have such a breakdown applied to purchases of clothing and that sort of thing?

Mr. Bell: It would be possible through the normal survey techniques adopted by the Dominion Bureau of Statistics, but to my knowledge that sort of survey has not been undertaken.

Senator Gélinas: On page 6, in the last paragraph, you say that the mineral industry enjoys special tax benefits that have existed for many years but are necessarily costly and inefficient. I should like to know why you say they are inefficient, and also what formula is suggested to replace the present assistance.

The Chairman: Are you asking whether he approves of the proposed change on the basis that it would be less costly and would be an efficient and adequate tax?

Senator Gélinas: Yes.

Mr. Bell: The White Paper spells out in some detail, although the detail is not all that clear...

Senator Connolly (Ottawa West): The emphasis is on depletion allowance.

Mr. Bell: The emphasis is on the depletion allowance. We listed this point because we thought the White Paper was definitely headed in the right direction here.

The Chairman: I do not know whether you were here yesterday when Imperial Oil appeared and we had a long discussion on the question of depletion. Their approach to depletion and the basis in the White Paper as against the existing basis was that they compete in the United States market in selling their product, crude oil, and that they must be competitive. They demonstrated that the new method would impose 25 per cent more in tax by reason of the change in the depletion allowance. In other words, they calculated that the present tax of $27 million a year which they pay would become $37 or $38 million. They say that to get that share of the United States market, which is part of their export market and their production of foreign exchange and so on, they must be able to compete on equal terms. Have you studied it from that point of view?

Mr. Bell: No, we have not gone into this in any great detail, but the fact remains that the depletion allowances themselves have been a kind of unnecessary bonus to all kinds of mining companies in terms of actual need for economic incentive in mining development.

The Chairman: There is no need to discuss depletion at all unless the company is making some money, there is no problem of tax.

Mr. Bell: That is right.

The Chairman: One looks at successful operations, and on looking at Imperial Oil, which is a very substantial operation in Canada, and find the change in method of applying depletion allowances is what the White Paper calls earned depletion—which to

me does not bear any reference to depletion at all; it is there to take care of the wastage. Three dollars spent can be written off and then $1 of depletion allowance is earned but there is a limit and one cannot in that way acquire a depletion greater than one-third of the net producing income.

Mr. Bell: That is right.

The Chairman: They say that on this basis, with their producing income and depletion allowances their taxes were $27 million or $28 million, but their overall tax is substantially more; the difference will represent a 25 per cent increase by reason of the change and they say they cannot compete in the United States market unless there is an allowance for depletion that will put them in about the same comparative position as the United States in that market. In the United States there is a 22 per cent depletion allowance on the gross producing revenues, whereas in Canada it is on the net. Being on the net, it means that before the allowances are calculated there has to be a deduction from production income of the money spent on exploration and development.

Mr. Bell: Do they suggest they base their argument that they cannot compete in the United States market on this fact alone without looking at other facts?

The Chairman: On the basis of the depletion it would make this difference in tax.

Senator Connolly (Ottawa West): That is applying the White Paper proposal.

Mr. Bell: Have other mining companies made the same point?

The Chairman: Yes, Noranda made the same point.

Mr. Bell: Have they provided what you consider to be realistic data?

The Chairman: Yes. They took their actual financial returns on which they pay tax, changed the method for depletion to that proposed by the White Paper and showed the impact. With Noranda there was a substantial increase in taxes too. Of course, Noranda said they could not deal with their operations in Canada on that basis, that they must therefore establish the capability of carrying on exploration and development operations outside Canada, where the climate was more favourable, and they would have to apply themselves to doing that. We have heard from Imperial Oil. We will hear from Hollinger and McIntyre, although I have not seen their briefs and I do not know what their position will be.

Senator Connolly (Ottawa West): Mr. MacDonald made reference at the beginning of the summary he read to organized campaigns. I take it by that you do not mean the representations this committee is hearing from the various industries that are prominent in our economy, because they think you recognize, as we do, that what we want to get at because of the far-reaching implications of the White Paper is what this does to the various segments of the economy. I am not saying this in any belligerent way, but looking at it from the point of view of the worker. I would imagine that your philosophy would be that the more prosperous a given industry is, whether it is manufacturing or otherwise, the better off the worker and that industry is going to be. Mr. Andras and I have been on this together on a number of occasions on boards of conciliations. The better your procedures are for improving the wage levels and fringe benefits, the better off the industry and the worker will be. The more competitive the industry is, not only at home but abroad, the more secure your worker will be of his job. As a matter of fact I think one of the biggest elements in the economy today is the power of the organized worker—the power of the C.L.C. This power has been used well. I remember Leonard Brockington saying that we have a great deal to thank the trade unions of Canada for what they have done in this country. I want you to understand that I feel that way also. It seems to me that you have got a much closer community of interest with the business community as we develop into a more technologically oriented age.

I feel that your interest in seeing that these industries in which your workers are so vitally affected should prosper by being competitive and by being able to develop and expand. Would you care to comment.

Mr. MacDonald: Yes, I would. Senator Connolly, to start with, your comment with reference to our comment concerning certain groups and individuals, who are currently carrying on campaigns directly against the principles advocated in the White Paper, I want to make it abundantly clear from the outset that we naturally will defend, protect and encourage anyone's right to criticize and

to express their views openly and without fear with respect to anything that takes place within our society. At the same time, we believe that such criticisms should be fair, honest and capable of substantiation. Some of the groups, as we have observed, who are currently carrying on their campaigns against the Carter Commission recommendation and more recently the White Paper certainly do not stand up under the application of that criteria. It is evident that what was in the forefront of their representations and what constitutes the whole burden of their approach is diametrically opposed to what we advocate. The Carter Commission recommendations, as we accepted them, were on the basis of equity. Obviously, we support that principle from everything we have said here. Those groups are determined that there will not be equity from our analysis and understanding and interpretation of what has been said. In fact, we see it as being a well mounted effort in many instances to ensure if possible, that the principle of equity will not be accepted and that the principle of special privilege will be enshrined. In fact, in some instances, it would appear that they are seeking even greater privilege and less equity. This is what we are talking about.

Senator Connolly (Ottawa West): I do not want you to give names, but would you identify the area. I take it that you are not talking about the groups such as we have heard here from the oil industry, mining industry, public utilities and people interested in pension plans and things such as that.

Mr. MacDonald: Perhaps there was as good a comment as we could make or an even better one which appeared in the leading editorial of the *Globe and Mail* yesterday morning, "A Corner on Fairness." It certainly dealt with this in considerable detail and we concur with what was said in that editorial. It went on in considerable length. I am sure that the majority of the committee members have read it. I do not want to read it all over again, but I would like to refer it to your attention as the type of thing we are talking about. It dealt with various aspects of the campaign that has been conducted by one such organization.

Senator Molson: Is it mentioned there, Mr. MacDonald?

Mr. MacDonald: Yes, it is.

Senator Molson: I have not read the article. You mentioned it because it is in the paper.

Mr. MacDonald: It is a matter of public knowledge. The *Globe and Mail* editorial referred to the Canadian Counsel for fair taxation.

Senator Laird: Could I follow up on that thought, having in mind an equitable tax system for everybody. I note with interest that you agree with the proposal to eliminate the special low corporation tax rate on small businesses. Now, have you any figures at all showing the proportion of people in Canada employed in so-called small businesses as compared to large ones?

The Chairman: Senator Laird, I take notice that the brief that has been filed opposes or at least criticizes one aspect of the two tier system of corporate taxation.

Senator Laird: I was going to come to that.

The Chairman: I think your question was aimed at finding out, if the benefits to small businesses—the 21 per cent on the first $35,000—were not extended beyond that and you found some method of application which would help only small business, what would the position of the C.L.C. be in that case?

Mr. MacDonald: We do suggest in our main submission that there should be other forms of preferential treatment. Our official view would be that up until this time small business has not received support and encouragement that it would be entitled to.

Senator Laird: As I read your brief I took a quick look at section 24 where it is shown that you feel that small business should have encouragement.

Mr. MacDonald: Yes.

Senator Laird: That was why I was trying to find out whether or not you have any figures available as to the proportion of employment between so-called small business and the so-called big business. I have heard a figure of 75 per cent of people in Canada are employed in small businesses.

Mr. Bell: That is far too high a figure. These figures are very readily available, but we do not have them with us.

Senator Connolly (Ottawa West): Perhaps you could give us a memorandum.

The Chairman: Mr. Bell, would you please provide them.

Mr. Bell: Sure.

The Chairman: Or if you do not have them would you send us a memorandum.

Mr. Bell: I would be very glad to.

Senator Connolly (Ottawa West): May I call on Mr. MacDonald. We cite here and read these representations from various segments of industry and I think these representations are as responsible as yours are. They say in certain areas that this White Paper is going to disaffect their industry very seriously. I say to myself, all right, if it is going to disaffect the industry then it is certainly going to disaffect the workers in that industry. They are a good deal more numerous than the executives in the industry. It is going to disaffect the shareholders in the industry, a great many of whom are workers too. Every industry has a different kind of complaint. Some say that the change proposed for small business is one aspect. Some complain about the changes that are made in the middle income group. Some talk particularly now about the extractive industries, which are very important to this country and indeed to the people, to all of the workers, that unless changes are made, then these industries are not going to be competitive. I suppose you would agree that, once they are not competitive, then this is going to disaffect the people who represent them.

Mr. MacDonald: I think that could be answered affirmatively, but I think it would be an over-simplification, would it not? Our general approach to it of course is that we must maintain a strong viable national economy.

The Chairman: That is right.

Mr. MacDonald: And that we naturally seek the highest possible level of employment. This is fundamental policy with us. To that extent of course we have to have regard to the interests of each individual industry within our economy. You have been very flattering in what you have said with respect to the strength and influence of the trade union movement in Canada. Frankly I cannot, though I would like to agree.

Senator Connolly (Ottawa West): This is a fact, is it not?

Mr. MacDonald: I would not accept it as such. As a matter of fact, my reaction would be quite different, sir. The fact of the matter is that I am very very sensitive, despite some degree of popular opinion to the contrary, about our very grave weaknesses. I do not want to go around expounding them. But it is a fact.

With regard to these industries, I think that one cannot generalize with regard to particular industries.

Senator Connolly (Ottawa West): I agree, but you can perhaps agree to this general one, whether there is agreement or not.

Mr. MacDonald: I realize that.

Senator Connolly (Ottawa West): There are some industries where there are special tax incentives provided and they say they need these, and I think in this country probably we would agree that they do need them—perhaps not to the extent that they get them, but to the extent that they get them surely there is an over spill of benefit to the workers who are engaged, who make their livelihood within these industries. So it seems to me that the first thing that one that is in common with those industries, is that they get these incentives so that they can develop.

Mr. MacDonald: Not necessarily. It might be or might not be, according to the particular circumstance relating to any particular industry. I have pointed out that we are interested in the economy as a whole, in Canada as a whole, in maintaining high employment in a viable economy and ever-rising standards of course for our people, and not for trade unionists alone but for Canadians as such.

Senator Connolly (Ottawa West): Quite.

Mr. Macdonald: In some instances, perhaps incentives and preferential treatment might be justified, in our view, towards the attainment of our goals and our objectives. In others, it is quite possible a much higher degree of equity can be introduced without affecting in the least the attainment or the achievement of the objectives which we set forth.

Senator Connolly (Ottawa West): The whole purpose of the Department of Economic and Expansion and Development, for example, is to assist, and it is not by tax incentives they propose to do it, it is by Government spending. Do you think that is the better method of attacking the problem, where industry is to be supported, or would you say that the tax act is the better?

The Chairman: Senator, do you not think we have explored this philosophical aspect far enough?

Senator Connolly (Ottawa West): I have finished now.

Mr. MacDonald: I would make one brief comment, if I may. I do not think that they are mutually exclusive.

Senator Beaubien: I wonder if Mr. MacDonald would tell us what different industries he represents. He can enlighten us on this point later on. What industries do you represent?

Mr. MacDonald: It yould probably be simpler to tell you what industries we do not represent. I am being conservative when I say that in this country we represent 1,600,000 workers who are members of our organization, covering practically every industry in Canada. So there are very very few left out.

It is true that in some industries we naturally have a much higher degree of organization and to that extent it could be said that our organizations are more representative. However, I think that it can be truthfully said that in general, in manufacturing, in basic industry, in transportation, in communications.

Senator Beaubien: And mining?

Mr. MacDonald: Yes, in mining we are very representative.

Senator Beaubien: And oil?

Mr. MacDonald: In services as such, which is an ever-increasing segment of our economy, we are not nearly as well represented, in fact very poorly. The same holds true of course in the commercial field, in the white collar field, and that sort of thing.

Senator Cook: On page 6 of your brief—I am on the point of a strong, viable economy—you refer to the unnecessarily costly and inefficient tax benefits given to the mineral industry. The evidence before us, which is very clear and is a matter of public record in other countries is that at the present time the tax situation of the mineral and oil industries is less favourable in Canada than it is in the United States, in Australia and a number of other countries.

Would you agree that if, at the present time, the tax climate for the mineral and oil industry is necessary in Canada, that the Government of Canada has a free hand to increase these taxes and thus diminish the mineral industry and the oil industry in Canada. And these are matters of public record.

Mr. Bell: This is one of the principles that was stated in the White Paper. It was the principle that was stated in the Carter Report. I think you have to look at this in conjunction with the whole raft of proposals that are contained in the White Paper and the Carter Report.

The Chairman: I do not think so, Mr. Bell, if I may interrupt. Let us just take the question of depletion.

Mr. Bell: I would like to complete my statement, if I may.

The Chairman: Go ahead.

Mr. Bell: The objective of the White Paper is to bring about a more equitable tax system and that was the objective as a matter of fact of the Carter Report. When we get into particular specifics like this, one thing that we have to bear in mind is that whatever concessions are made in this particular area or in any other area, if those concessions are necessary, that is fine, but we do not want any concessions to be made that are going to prevent the attainment of the primary objective of bringing about an equitable tax system. We do not want any concessions to be made that are going to prevent the attainment of the primary objective of bringing about an equitable tax system. The same thing applies, senator, to the present double tax rate on businesses.

Senator Cook: My point is that for you to say that the tax benefits that have existed for years are unnecessarily costly and inefficient is merely an expression of opinion. It is not a fact. The facts are that the tax benefits are less costly and inefficient, if you want to use those terms, than is the case in the other developed countries. That is the evidence we have. Now, how can you then go ahead and make the tax burden even more difficult for the mining and mineral industry. The inevitable effect would be not to make the economy stronger and more viable but less strong and less viable.

Mr. Bell: This is a general principle that applies across the board. There are all kinds of mining explorations that have taken place in this country that have taken undue advan-

tage of this particular tax concession. There are plenty of them. Scads of them over the years. And this is precisely why this particular principle was incorporated in the White Paper and why it is the same kind of principle, as a matter of fact, that was recommended by the Carter Report.

Senator Cook: We have differences of opinion.

Senator Hollett: On page 6 you say that corporations are taxed in ways that are open to abuse.

Mr. Bell: Yes.

Senator Hollett: Well, that is true not only of corporations but of all of us, isn't it?

Mr. Bell: This particular point, senator, refers very specifically, and this is my interpretation, to the existin double corporation tax rate which the White Paper recommends abolishing.

Senator Hollett: I see. That is the explanation.

The Chairman: Mr. Bell, I think it would be a fair comment for me to say that you appear to be prepared on the question of the mining industry and the oil and gas industry to accept the White Paper as having a corner on fairness in taxation. Having made that observation, I note in looking at the White Paper itself that what the Government says is this:

> The government has concluded that special rules are still needed for the mineral industry, but that they should be revised substantially to ensure that really profitable projects bear a fair share of the burden of taxation. It is recognized that the exploration for and development of mines and oil and gas deposits involve more than the usual industrial risks and the scale of these risks is quite uncertain in most cases. Consequently, special arrangements are desirable to ensure that the costs of exploration and development may be charged for tax purposes as early as possible in order that taxes will only be applied when it is clear that a project will be profitable.

Then they conclude:

> Secondly, it is recognized that the exploration for and development of mineral deposits continue to provide special benefits to Canada and to various provinces by creating or maintaining highly productive industry in areas other than those where rapid urban and industrial growth are already occurring as a result of both private and public efforts.

This is the basis of what they say, and what they say is that the method that is in existence at the present time, that special treatment, should be changed so that there is an exposure to tax when the special needs of the industry have reached the point where they are being well served and are making a profit. Therefore, we have to start off on the basis that we are dealing with a special subject, one which the Government itself recognizes needs special treatment.

Now, I asked you a question earlier as to whether you had made a study of the impact of the proposed changes in the White Paper in dealing with depletion. I was a little concerned, although I did not follow it up at the time. I told you what the Imperial Oil Company said to us. It appeared to me that you had not made a study of what their position is. I don't know how any person can undertake to express an opinion as to the impact of these proposed changes without having made that kind of study. All the Government does in the White Paper is to express a viewpoint. They think that the method they propose will come closer to giving them the special treatment and also providing an exposure to tax at the time when they should be exposed. But there are two sides to every question and I would think that before you express an opinion and say that you support what the White Paper says, you should know the other side of the question.

Mr. Bell: But we are not denying, senator the fact, either in the context of this particular point or the context of any other point in this memorandum in relation to business, that, where it is essential to provide an economic incentive to business, that economic incentive should be made available.

To me this is the whole crux of the problem. In so far as these particular existing concessions are concerned, we don't want them to distort our present tax system and continue to make it inequitable. The same thing applies to small businesses.

The Chairman: Don't let's move away from mining and depletion now.

Mr. Bell: But the same principle applies, sir.

The Chairman: Let's stay with the mining industry.

Mr. Bell: If it is necessary to provide economic incentives for mining, or whatever it may be, for the purpose of promoting economic development and industrial or mining expansion, then my personal opinion is that those incentives should definitely be provided. But they should be provided in such a way that does not involve the continuation of our present inequitable tax system.

The Chairman: I can certainly go along with the principle that you have stated. I can buy that. But it is when you make the jump at the end that the special privileges or economic provisions must not, the ones we have now, must not be continued because they are too costly and inefficient, the proper question for me to ask and I think the answer that you should be prepared to make...

Mr. Bell: I think it goes right across the board.

The Chairman: Just taking the mining industry, where in the economic benefits that are given to the mining and oil and gas industry today are they too costly and inefficient and where do you go to look for that information? You go to the industry, don't you, and you see how it is doing. That is the first determination you have to make before moving on and saying we are going to change the rules. We know in changing the rules you still call them special benefits, but it will lead to expanded taxation in some industries which are the backbone of our economic system. We have heard Noranda and Imperial Oil, and anything they have said is a matter of public record. All I am trying to do now is put a value on your agreement with the provisions in the White Paper to change these special rules, and the measure of the value that I can put on it, as a matter of judgment, must depend on the background of the particular knowledge and information that you have.

Mr. Bell: All I can do, sir, is to repeat what I have said. There is not one word in this submission to indicate that we are advocating anything that is going to deter economic incentives for the purpose of bringing about the maximum economic expansion in whatever industry you may want to consider.

The Chairman: I am looking at the language at the bottom of page 6.

Mr. Bell: That is not my language or the language of the Canadian Congress. It is the White Paper language.

The Chairman: You have adopted it so I assume it is the Canadian Labour Congress speaking when you adopt the language of the White Paper. You say that the mineral industries enjoy special tax benefits that have existed for many years but that are unnecessarily costly and inefficient.

And I say, show me where.

Mr. Bell: Those words apply across the board to mining operations that have taken place in this country for years and years. They don't apply to any specific mining company or any particular enterprise. This is a general principle.

The Chairman: I can answer you the way Mr. MacDonald answered Senator Connolly (Ottawa West), then. When Senator Connolly was putting certain philosophical approaches, Mr. MacDonald said, well, now, you can't generalize on this. Now, what I say, turning it back to you, is, I don't think you can generalize on this.

Senator Molson: Mr. Chairman, I have three questions to ask Mr. MacDonald. First, I should like to come to something that has not been treated in your brief, Mr. MacDonald, namely, the question of expense accounts. This has been one of the subjects dealt with in most of the submissions we have had, the matter of eliminating expense accounts, attendance at conventions, the use of provided automobiles. What is your view or what is the view of the CLC on this particular part of the White Paper?

Mr. MacDonald: You are quite right, senator, we did not deal with that in our submission. Our view would be that there are expense accounts that can very well be justified, and in the ordinary course of business are necessary. But is is the abuses that have to be dealt with, and I do not want to be pinned down by the Chairman with regard to particular abuses that have been, I would say, almost notorious over the years.

Senator Molson: That I think would be generally agreed.

Mr. MacDonald: But we ourselves within our operations naturally have to use expense accounts too.

Senator Molson: But conventions are surely very important to you.

Mr. MacDonald: They have to be within our democratic process.

Senator Molson: Because one of the things mentioned in the White Paper is the expense occured in attending conventions.

Mr. MacDonald: We think conventions are important, as you suggest, and we feel there should be recognition of this. Incidentally we do not, within our own movement, of course get any special consideration for our conventions. Our expense system is different and it is approved and there is no allowance or taxation relief in so far as our expenses are concerned.

Senator Molson: That would be different, but if the individual had to bear the impact, it would make a difference to him.

Mr. MacDonald: Yes, but it is the abuses which require correction.

Senator Molson: Don't you have cars belonging to the union used by executives of the union?

Mr. MacDonald: Yes, many of our unions provide cars for those who require them in the course of their work.

Senator Molson: Are union dues deductible?

Mr. MacDonald: Yes, there is a distinction made and probably you are aware of it. The proportion of the union dues realized for straight union purposes are deductible.

Senator Molson: That excludes any political or other similar activity. But what proportion is deductible?

Mr. A. Andras, Director of Legislation, Canadian Labour Congress: If I may, Mr. Chairman, the Income Tax Act recognizes that that part of the dues payment which is directed to the administration of the union as such. There are some unions which have dues covering a variety of purposes such as the pension plan, weekly sickness payments and so on, and these are covered on the receipt provided by the union to the individual.

Senator Molson: Are union dues graduated based upon the amount that the member earns?

Mr. MacDonald: There is a variety of systems there. There are some of our unions that determine their dues as a percentage of the earnings, but I would say that, that is rather a small minority. By and large it is a constitutional amount that is determined by the members.

Senator Molson: The local?

The Chairman: A flat rate?

Mr. MacDonald: In the majority of cases there is a variety of systems. It is not laid down by the local usually, although that is so in a number of cases. Some of our unions have the system that the union itself determines a minimum amount of dues that should be charged to the members, and then it is within the authority of local unions to increase it to a certain sum over and above that minimum.

Senator Molson: They might also have some special purposes that might increase it, possibly for something just above the minimum activity. They might have their own special purposes for which they need additional funds.

Mr. MacDonald: There can be any number of different reasons why local unions as such will assess their dues at a higher level than the minimum provided for in their constitutions, if they have the authority to do it, and the majority of them have.

Senator Molson: It seems quite apparent that if the White Paper were implemented by legislation, that the great brunt of the taxation load would fall on people or on individuals who by and large come into what I would call the union member and the junior staff member which I think I said before comprises probably the brightest and best cross section of working individuals, and would also be the biggest threat perhaps to our brain-drain. Now you have not made any comment on the fact that that is where these changes seem to lead us, and I for one find this disturbing because it is quite right to raise the exemptions and eliminate more people, but we promptly jump into a higher rate just about where I would suggest that most union members and junior staff come in.

Mr. MacDonald: But we have commented on that senator, if I understand your question correctly, on page 9 of our memorandum. There we have pointed out the anomalies and contradictions as we see them with the

principle of equity with what is proposed in that respect in the White Paper. It is one of the sections in the White Paper we have criticized and we have set forth our views on that point at sections 19 and 20 on page 9.

Senator Molson: I saw that when I read the brief, I am sorry. Perhaps what I should have said is that in the criticism you imply here I do not think you offer any solution. I don't think they can reach a balance and I doubt very much if the sums desired can be achieved by correcting the faults you mention here. In other words, the money has to come from somewhere.

Mr. MacDonald: Certainly we make our position clear throughout in this memorandum that we recognize that government has to have the revenues and even if it means additional revenue, as long as it is properly utilized we are not voicing any criticism on that at all. But what we are doing here is simply pointing out the anomalies that exist. We are not saying for a moment that the revenues to government should be decreased as such, but we do believe that we have pointed out here that the burden should be more equitably imposed. It is quite possible, as you realize, to impose the overall burden much more equitably and derive the same revenue as an ultimate result.

The Chairman: Following on what Senator Molson has said, you make some comment in your brief on the question of the exemptions and the increase in the exemptions. What occurred to me was, would you regard it as being equitable if your method of establishing the application of income tax were to some extent on the basis of the amount of income? For instance, instead of saying that every single person is entitled to $1,400 of exemption and every person of married status is entitled to twice that amount, up to a certain level of income you simply said, without talking about exemptions at all, that a single person in receipt of "X" amount of dollars in a year is not subject to income tax, and a person with married status up to a certain amount is not subject to tax? By doing that you get away from any suggestion that there is discrimination in increasing exemptions and applying them the whole way up the scale. Part of the substantial revenue the Government wants to make up is because they say, "In giving these increased exemptions and applying them the whole way up the scale we have lost over $1 billion in tax revenue."

Mr. MacDonald: It is analogous, in some respects, to the dual system under corporation taxes.

The Chairman: There could be no objection in equity in eliminating exemptions up to a certain level and saying, "There is no tax, on income up to that level" and you would not criticize that method?

Mr. MacDonald: No.

Senator Beaubien: Could you tell us what the average yearly income of your members would be?

Mr. Bell: There is data available on the average income of trade union members, but I think we can make an approximate guess. The average income in industry today—and this is a very broad, national average—ranges between $5,500 and $6,000. Incidentally, we would be very happy to supply you with specific figures on that.

The Chairman: Yes, we would be interested.

Mr. Bell: Yes, we can provide you very quickly with those figures.

Senator Isnor: I have a question for M. Bell, but before asking Mr. Bell anything further in connection with the sales tax I would like to ask Mr. MacDonald, at the same time complimenting him on the summary of his brief and the manner in which he placed it before us: There has been considerable criticism, Mr. MacDonald, from the public in general in respect to the policy adopted by Mr. Benson in distributing the White Paper. What do you think of his method?

Mr. MacDonald: In distributing it?

Senator Laird: Senator Isnor means, the opening up of discussion on the subject of tax reform.

Senator Flynn: Rather than introducing a bill.

Mr. MacDonald: We think this is a good system. It gives the opportunity to all people within Canadian society to express their views on it, to make their representations and have an opportunity of assessing and analyzing it over a period of time. Now, we are not critical of that.

The Chairman: Even if you disagree with some of their criticisms?

Mr. MacDonald: Yes, that is the reason for doing it.

The Chairman: I just noticed earlier that you were sort of reflecting on some organizations who were saying things about the White Paper.

Mr. MacDonald: Yes, because I think I established some criteria at that time on the basis of which criticism and representations should be directed to it.

The Chairman: You were not agreeing with their criticisms, but you were not denying their right to criticize?

Mr. MacDonald: No.

Senator Isnor: I just wanted to make that clear, you coming from such a strong organization as the CLC.

Coming back to the question raised by Senator Carter with respect to sales tax, we got into difficulty, I think, in not having a clear understanding in respect to the manufacturers' tax as administered by the federal Government and the retail sales tax as administered by the provincial governments. When you refer to the fact it should be reduced, which do you mean, the federal Government's manufacturers' sales tax...

Mr. Bell: Yes. On that particular point I was referring specifically to the federal general sales tax, but in general principle I would like to see general sales taxes, as applied at the federal level and also at the provincial level, reduced for the sake of bringing about a more equitable tax system.

Senator Isnor: We are getting back into the same field you were in a little while ago, mixing the two. I am asking you which you favour, a reduction in the manufacturers' sales tax by the federal Government...

Mr. Bell: Yes, very definitely.

Senator Isnor: How would you replace that revenue?

Mr. Bell: I think there has to be a shift from that kind of tax, which is very highly regressive, to the personal income tax. I do not see any other way you can raise the amount of revenue that would be lost as a result of the reduction of your federal sales tax. I do not see how you could raise that revenue by any more equitable way than the personal income tax, because it really is about the only progressive tax aspect of our tax system.

Senator Isnor: Then, as I understand it, you favour a reduction in the manufacturers' sales tax and an increase in the income tax to the same extent?

Mr. Bell: I think that has to be the case. I do not see how else you can do it, unless you shift it to some other form of our tax structure which would not get away from the inequitable aspects we are trying to get away from.

Senator Isnor: Then you are favourably disposed towards an increase in income tax?

Mr. Bell: Personally, that is very definitely my position.

The Chairman: Just wait a minute. I did not understand Mr. Bell to say—and he can correct me if I am wrong—that he is in favour of an increase in personal income tax rates. What I understood him to say was, "If you reduce the federal sales tax, you must pick up the income somewhere else. Then, for that purpose, I would favour an increase in the personal income tax."

Mr. Bell: That is right.

Senator Flynn: Do you suggest the sales tax is not equitable because there is no relationship between income and the expenses of the individual?

Mr. Bell: Because it is most definitely not based on the ability to pay. That is precisely the point.

Senator Flynn: You are entirely sure of that?

Mr. Bell: Yes, we are entirely sure of that; there is absolutely no question about it. Studies have been made on this but, as a matter of fact, common sense itself indicates this.

Senator Hollett: Do you mean that the C.L.C. is in favour of increasing the personal income tax?

Mr. Bell: In order to bring about a reduction of the present highly regressive sales tax, and if it is necessary to make up that loss of revenue which obviously must occur, I think there has to be an increase there, unless we are prepared to reduce Government expenditures.

Senator Hollett: But do you not understand that the man with the low income is not

forced to buy the stuff on which the sales tax is imposed. He does not have to spend that money.

Mr. Bell: The fact is that he spends virtually all of his take-home pay, and he spends that money on all kinds of goods on which the general sales tax is imposed. The major exception is food.

I referred some time ago to the suggestion of the Carter Commission that the sales tax be reduced to 7 per cent and imposed at the retail level. That seems to be a reasonable proposition for the federal Government to consider. If this were brought about it would be a considerable step towards improving the equity in our tax system.

Senator Isnor: Mr. Chairman, I think I cleared up the point I had in mind, but I should like to correct Mr. Bell in respect to provincial sales tax. It is not imposed on everything that is sold.

Mr. Bell: I beg your pardon?

Senator Isnor: You stated that the general sales tax applies to all articles, with the exception of food. That is not quite a true statement.

Mr. Bell: I was referring to the federal sales tax. I was not referring to the provincial sales taxes.

Senator Isnor: I see. There is no sales tax on children's wear, for example.

Mr. Bell: That is true. There are a few minor exceptions, but the major exception so far as the federal sales tax is concerned is food.

Senator Beaubien: Mr. Bell, we have had two or three studies presented here that show that the income tax in Canada is roughly 30 per cent higher than the equivalent tax in the United States.

Mr. Bell: Are you referring to the personal income tax in Canada?

Senator Beaubien: Yes, that is what I am talking about. These studies show that it is 30 per cent higher than it is in the United States.

Mr. Bell: I very much doubt that.

Senator Beaubien: We can give you a great deal of material on it.

The Chairman: Yes, we have had studies made.

Senator Beaubien: There has not been anybody representing a big company appearing before us and who has not told us about that difference in the tax. But how could you possibly increase it to replace the loss of revenue that is yielded by the sales tax. I do not know what the total amount is that is yielded by the sales tax, but it is enormous.

Mr. Bell: The sales tax itself?

Senator Beaubien: Yes. You are talking about abolishing the sales tax, and replacing that revenue by an increased income tax.

Mr. Bell: I have not the figures here, but we checked them over some days ago while preparing our memorandum. If I am not mistaken, the federal sales tax itself yields approximately $2 billion.

Senator Beaubien: Yes, it is something enormous.

Senator Carter: Mr. Chairman, may I ask the Canadian Labour Congress if they would supply us with the basis of the calculation in section 17, where they say that their own calculations show that the general sales taxes and real property taxes accounted for about 40 per cent of the total tax revenue, which is to be compared with the figure of 25 per cent mentioned in the White Paper. I should like to have the basis of that calculation.

The Chairman: Would you furnish us with that, Mr. Bell?

Mr. Bell: Yes. In fact, I have the source of this here, but if you want us to send you a memorandum on it then I shall be very happy to do so. The figures that are given in the White Paper itself—it is rather difficult, as a matter of fact, to interpret just what is meant by the language in that particular section of the White Paper, but the White Paper itself indicated that the general sales tax—and the reference here is not only to the federal sales tax but also to provincial sales taxes and real property taxes which, of course, are levied by municipalities—amount to $6.9 billion of the $27.6 billion, which was the estimated revenue of all governments in the year 1969. When the White Paper was published, of course, its authors did not have the exact figures, but this was the estimate that they made.

Our own estimate is that these taxes, which the White Paper admits bear heavily on the low income groups, make up about 75 per cent of all Government revenues.

The amount indicated in the White Paper resulting from the general sales taxes and the real property taxes are probably, from our calculation, understated—"understated" may not be an appropriate word to use here, but the figure depends upon what they are actually referring to. We have looked at these figures. If you take into account the federal-provincial general sales taxes plus a lot of other taxes, such as the tax on motor fuel and fuel oil, and the taxes on alocholic beverages, amusement admissions, tobacco, and so on—we can send you a memorandum on this—it seems to us that the actual amount yielded is considerably higher than what is indicated in the White Paper.

Senator Flynn: Would you be able to supply us with figures to show what these taxes represent to the consumer with an income of $4,000, $6,000, and up to $15,000, to prove your point that these taxes are not equitable? I suggest to you that the real estate tax on a $50,000 home is much more than that paid by a man who rents an apartment for $75 a month.

Mr. Bell: Who rents an apartment for $75 a month now, sir?

Senator Flynn: I suppose some people do. I know of places where you can find them.

Mr. Bell: Unfortunately, there are no figures available to answer the question you have just put, but as the White Paper indicates, and as we know from our own personal experience, real property taxes do bear heavily on persons in the lower income groups who have to pay the existing very high rents. We know that rents have gone up substantially.

Senator Flynn: But I am suggesting to you that it is all in proportion to the income of each individual.

Mr. Bell: This is true, but it is precisely because it is proportionate to the income of the individual that it is not a progressive tax, as opposed to our income tax. Regardless of whether our present income tax graduated rate structure could be more progressive than it already is, the fact remains that the progressive principle is inherent in the income tax.

Senator Flynn: You suggest, therefore, for instance, for water, electricity and streets that there is not the same rate for all, that someone who earns $4,000 a year should pay less for water than someone earning $10,000 a year, yet these taxes are intended to cover services for all.

Mr. Bell: I know, but applying the principle of equity to the payment for providing services, whether at the federal, provincial or municipal level, if you are interested in making payments for these services in accordance with ability to pay, all I am saying is that the real property taxes and sales taxes are a contradiction of that principle of ability to pay.

Senator Flynn: You suggest scaling it according to the purchaser or user.

The Chairman: Perhaps we can leave that. Senator Flynn, you have indicated what you would like to get in the way of information. Mr. Bell is arguing that it may not be available. Let us put it this way. If he submits whatever he has on the subject and there are further points that we want covered, we will write to him and tell him so.

Mr. Bell, on what Senator Beaubien said about the percentage difference in the personal income tax rates between Canada and the United States, we have had studies made to establish what Senator Beaubien said to you. I was wondering if you would send us the figures you have as the basis of calculation.

Mr. Bell: Perhaps I could say one thing for the purpose of clarification so that we are not considering this matter at cross purposes. It was suggested that the American personal income tax was much lower than in Canada. Are we talking about the tax rates taking into account exemption levels? Our exemption levels are higher in Canada than they are in the United States, as you are probably well aware.

Senator Beaubien: I am talking about the only place where one can get any added revenue, because the tax on the lower brackets cannot be raised. For those earning between $9,000 and $25,000 in the United States the rates are about 30 per cent lower, for a number of reasons. First, the income can be divided with the wife in the United States and each pay on half. Secondly, the sales tax on a refrigerator bought in the United States can be taken off the federal tax. We have had exhaustive studies, and unquestionably look-

ing at the two rates there appears to be a tremendous difference, simply because they have these provisions. In the United States house mortgage interest can be taken off the federal tax. With inflation, which will affect your members, this is very important to you.

Mr. Bell: This is really the difference in sales tax between the two countries.

Senator Beaubien: This is not sales tax.

Mr. Bell: Personal income tax.

Senator Beaubien: This is personal tax.

Mr. Bell: Because the Americans do not have federal sales tax, although in various states there is a sales tax.

Senator Molson: Could I return to the question I asked a little while ago?

The Chairman: You can have a second run at it.

Senator Molson: I worded my question to Mr. MacDonald somewhat poorly a little while ago. Paragraphs 19 and 20 point up inequities in the low scale and high scale. I do not think anybody quarrels very much with the ability to pay, principle and equity in taxation. I think it can be said that people accept this. However, Mr. Bell just said that he wants to eliminate a lot of the sales tax and get the revenue from income tax. Again based on the ability to pay this is a fair enough idea, but to me it is way out yonder, because what is being suggested is that we have to start backing at the man earning $25,000, but we all know from the statistics issued by the Government every year that putting 100 per cent at the top end will not achieve what Mr. Bell is suggesting. I would like to ask him how he would graduate the tax rate so that we have an equitable system and get the money needed by the federal treasury. I do not necessarily disagree with what he said, but I merely ask him how he suggests this could be done practically.

Mr. Bell: There is no problem in doing this. It may be politically unacceptable; there may be political problems involved. I do not know, and I am not qualified to comment on that. Certainly there is no difficulty in using personal income tax for raising more revenue than it already yields. This would be a much more efficient way of raising that revenue than the present system, because as consumers we are paying so many tax dollars—which are hidden tax dollars, of course, because the sales tax is imposed at the manufacturer level and, as everyone knows, becomes incorporated into the actual price paid for the good by consumers. We pay those tax dollars every time we make a purchase, but we are not aware of the fact we are paying those tax dollars. I suppose that is what makes the sales tax politically acceptable.

Senator Molson: I did not ask that question. I asked how you would graduate this income tax scale.

Mr. Bell: There is no problem.

Senator Molson: It is not a problem, but that is not an answer. You do not want to put it on the low end or the middle end, and there is justification for saying that. It has to be put on the top end.

Mr. Bell: No, I did not say that.

Senator Molson: How will you replace the billions from the upper end of this scale?

Mr. Bell: I did not suggest it would be put on the top end.

Senator Molson: It has to be.

Mr. Bell: No. Look at the amount of tax revenue now collected by the federal Government through the sales tax. Suppose for the sake of argument the sales tax were abolished altogether, although I am not suggesting it should be. If it were abolished altogether and there was about $2 billion to make up, if we did not want to lose that part of the total government revenue there is no reason why the present personal income tax could not be shaped to raise that additional revenue.

Senator Flynn: By lowering the exemptions.

Mr. Bell: Through the graduated tax structure. That is a principle inherent in our personal tax system.

Senator Flynn: If you lower the exemptions.

Mr. Bell: This may very well be the case.

Senator Connolly (Ottawa West): Or raise the tax rates.

Mr. Bell: Or increase the tax rates. There are a number of ways in which this can be done.

Senator Connolly (Ottawa West): You reach a point in the level of taxation that discourages initial earnings.

Mr. Bell: I fully agree; I think this is right. At the same time, we do not know what that limit is. The fact of the matter is that as consumers we are paying out tax dollars all the time through the sales tax. As a matter of fact, we are paying more as a result of the pyramid effect of that sales tax than the actual 12 per cent collected by the federal Government.

Senator Molson: In graduating your tax, Mr. Bell, you would have to get the majority of this $2 billion out of the brackets which would not be called high brackets and would include a lot of your members and junior staff, as I mentioned before, because that is where the big chunk of the money is shown statistically to be taken by the federal Government.

Mr. Bell: That is true, but they are paying more now through the sales tax than they would if some of this—and I did not say all of it, but only some of it—was shifted to the personal income tax.

Senator Connolly (Ottawa West): Could you show us that in a memorandum, please?

Senator Molson: Yes, that would be very interesting.

Senator Connolly (Ottawa West): I think it is very important.

The Chairman: Gentlemen, we seem to have run through the aspects of the sales tax and its impact on personal income taxes.

Now, moving to a different subject, I would like to ask Mr. MacDonald if he favours a capital gains tax on the principal residence of a taxpayer, or on what we would call the homestead property of a farmer?

Mr. MacDonald: No. I think we have made that point clear in our brief.

The Chairman: Yes, except that you have said something here that is not in accordance with the law. As a matter of fact, you have good company in making what I would call a misstatement. The Minister himself in his speech to the Real Estate Association a few weeks ago, when he was asked about why they had to provide for a capital gains tax on the principal residence, gave an explanation to them, and his speech is on record, to the effect that otherwise there would be a gaping hole in his capital gains method of approach. He said that that gaping hole would permit the wealthy people to use their money to acquire, I assume in succession, a principal residence and make substantial money.

You have taken a different approach here, but you give the same reason. You say that the buying and selling of houses for personal use or for the purpose of aiding mobility in job changes should be treated differently for tax purposes from that of the real estate broker who makes a business of buying and selling houses. I just want to tell you that that is the law now. The only kind of real estate transaction at the present time that has any certainty of escaping income tax is the sale of a principal residence of a person or the sale of a homestead property, because the law as interpreted by the courts has said that this is an adventure in the nature of trade. So that when the Minister says there is a gaping hole and that the wealthy people can move in there, I say the moment they start buying and selling in succession that is a business under the present law, and you don't need anything more in the law, they would be taxable.

I agree with your view that the business of buying and selling houses for personal use is surely one domain where the man should, as his condition improves, be able to move from one class of house to another and to be able to use the proceeds and not to have to surrender part of his gain. Inevitably, real estate has gone up in value. Part of it is reflecting the inflation situation in Canada. Therefore, I assume that your position is really the present law.

Mr. MacDonald: Actually, I am not familiar with the law at first-hand, but if the present law coincides with this view, then yes.

Senator Connolly (Ottawa West): Well, a lawyer has just told you what the situation is.

The Chairman: Osmosis may apply here. The fact that I am sitting so close to Mr. MacDonald may cause some of the legal knowledge I have to rub off on him.

Mr. MacDonald: I have been subjected to a lot of association with legal rights over a long period of time.

The Chairman: You think you have had too much osmosis?

Mr. MacDonald: Well, it has not done me much good.

Mr. W. Dodge, Secretary-Treasurer, Canadian Labour Congress: I don't think much of the suggestion that people with acertain amount of wealth are going to go through some sort of exercise, living in a property, selling it and buying another and selling it and buying another, and so forth, with the express purpose of evading taxes by changing residence frequently. I don't think really that is a possibility.

The Chairman: The present law would not permit it, in any event.

Mr. Dodge: But, if they were to buy a property for their personal use, they might, through some sort of exercice, living in a to buy a better one, a bigger one, a more luxurious one and so on. But I don't think they would really do that for the purpose of evading taxes. I just don't see it.

The Chairman: It might be for the reason of personal vanity.

Are there any other subjects that the committee would like to question Mr. MacDonald on?

Senator Laird: Referring to your paragraph 24, Mr. MacDonald, presumably speaking of small businesses you say something to the effect that more effective means should be explored to facilitate the entry of new businesses into the Canadian economy. Precisely what would you have in mind there by way of incentives?

Mr. Bell: I think one would be acceleration of depreciation allowances. This point with regard to the double...

The Chairman: The two-tiered tax.

Mr. Bell: With regard to the abolition of the two-tiered corporate tax system, I think, has been very badly misunderstood by a lot of small business people in the country. I say this only from a reading of some of the press reports. The present tax system I don't think is particularly effective, really, in enhancing the position of small businesses, particularly real genuine small businesses. I think that other methods such as accelerated depreciation allowances or other forms of preferential tax treatment would be much more effective in bringing small businesses into our economy and making them viable.

Senator Laird: Would that be the only suggestion you have?

Mr. Bell: No, most definitely not. Small businesses should have much easier access to capital than they do at the present time. They are too dependent on chartered banks for their financial requirements. They have not got the means available to larger businesses for going into the capital market. As a matter of fact I have not really made a study of this for some time, but it seems to me that one of the most significant things that developed in favour of the smaller businesses was the Industrial Development Bank which was established in 1944.

Senator Laird: Precisely.

Mr. Bell: You can correct me if I am wrong, but I don't think that since the establishment of the Industrial Development Bank in 1944 there has been any really significant development in so far as aiding small businesses.

Senator Connolly (Ottawa West): Oh, well, it has been extended.

Mr. Bell: You are talking about the Industrial Development Bank and its operations being extended, and that is quite true, but at the same time I don't think that there has been any sufficient development with regard to small business.

Senator Connolly (Ottawa West): You want it extended further, in other words?

Mr. Bell: Yes, very definitely.

The Chairman: Mr. Bell, in answering Senator Laird, you said that you did not think that the two-tier system was the proper way of assisting small businesses.

Mr. Bell: Right.

The Chairman: You realize that a 21 per cent tax on the first $35,000 of taxable income in a small business would enable it to retain something over $10,000 a year. Bearing that in mind, we have had the B.C. Forest Products Association representing all the different logging interests, et cetera, out on the coast, and they have shown us factually the impact on their business of lack of ability to get credit, so they have to generate their working capital themselves.

$10,000 a year of savings on $35,000 a year of taxable income would soon add up to a very generous amount of retained earnings in

the business and could be the base for substantial credit.

I invite your comment on this, that the difficulty, I think, was when they granted the 21 per cent. It started out at 10 per cent, I think, and when they granted the 21 per cent on the first $35,000 they called it a favour to small businesses, but they gave it to every corporation.

Mr. Bell: Yes, precisely.

The Chairman: If you are justifying it on the basis of small business, that is where it should be, and only there; and small businesses should have been defined in terms so that you would limit the application.

Mr. Bell: Yes. As a matter of fact, there may be very considerable merit in the point you have just made. This prompts me to ask you this question: If that be the case, why should unincorporated businesses not benefit likewise? We have hundreds of thousands of unincorporated businesses in this country.

The Chairman: Of course, they could incorporate.

Mr. Bell: I do not know whether they could or not.

The Chairman: If they have a number of partners, each one carries his percentage of his income and, therefore, he may be getting a low personal rate.

Senator Connolly (Ottawa West): But the corporation is not a problem.

The Chairman: Senator Molson, you remember you were asking about where you were going to fit in the tax revenues you would give up by repealing the sales tax. You will remember that we had a chart prepared by Mr. Gilmour, our tax consultant, and in a pyramid fashion it showed the number of taxpayers at different levels of income. For instance, when you get up to the area of $50,000 to $100,000 as an income class, you have 7,243 people; when you get up to the $100,000 to $200,000 class, you have 1,005 people; and when you get up to the $200,000 and over, you have 140 people. These are what the income tax returns disclose.

It is quite obvious from that that is not an area from which you could hope to recover the $2 billion you would give up in sales tax.

Mr. Bell: I fully agree with you. I was not suggesting that for one moment. As a matter of fact, to suggest that would indicate one had never taken arithmetic in school!

Senator Molson: I knew you were not suggesting that, but I was trying to find out where you thought it could be spread, because the bulk of the money comes from the middle area.

Mr. Bell: That is quite true.

Senator Molson: That is the group you really do not want to soak.

The Chairman: I think the middle area is being hit too hard in the White Paper proposals.

Senator Molson: That is one of our objections, that it hits the lower middle group too hard. At least, there has been some expression of opinion about it.

Mr. Bell: My contention is that the lower income group is being hit harder under the existing tax set-up with the sales tax.

Senator Molson: We derive $2 billion from the sales tax and to relieve that burden we need more money from elsewhere. I do not know where it is to come from.

The Chairman: We will have to take a course in magic.

If there are no further questions: Mr. MacDonald, I want to thank you very much. We have enjoyed your presentation and we have received some useful information and points of view from you that we were anxious to get. I wish to thank you, Mr. Bell, Mr. Dodge and Mr. Andras, too.

Mr. MacDonald: Thank you, Mr. Chairman and honourable members of the committee. We also have certainly enjoyed our opportunity of being with you, and we do hope that we have contributed something to what we regard as your extremely important work.

The Chairman: Yes, you have, thank you very much.

The Chairman: Now, honourable senators, we have one more submission, that from Mr. Harry R. Jackman, Q.C., who is going to discuss certain aspects of the White Paper proposals, including its social implications, foreign investment, and the capital gains tax. the floor is yours, Mr. Jackman.

Mr. Harry R. Jackman, Q.C.: Mr. Chairman and honourable senators, it is a great privilege for me to be allowed to come here and present the views I have. I may say that when some of my friends protest very violently about the White Paper I suggest to them that they come down to Ottawa, or ask for permission to; but, of course, nothing happens.

I might say that to endeavour to study the White Paper with all its implications, particularly if you are a very small organization, is quite a formidable undertaking. I am rather glad the hearing is today and not three months from today, because I should still be working on it. It is a very deep and penetrating sociological document, as well as having something to do with the raising of taxes.

If my remarks require a title I should suggest, "You cannot have eggs without chickens, and you cannot have capitalism without capitalists."

Briefly, I shall hope to address my remarks to the effect of the White Paper on the vital problem of creating and accumulating capital for the production and development of Canada's resources. Were it not for the fact that I am in my seventieth year, some of my proposals might be considered to be selfish or, at least, self-interested. However, I speak from some training in the law, old-fashioned economics and 50 years in the financial business, and I should like to quote briefly what is almost the inevitable philosophy of a Canadian successful in the economic world. He begins by learning his trade; he saves his small stake, borrows from the bank, starts a business and, if successful, creates employment and provides goods and services for the people. In his forties he may start making some money. In his fifties his standard of living is pretty well established. Because of the general affluence, domestic servants are almost impossible to get. Probably corporatewise or personally he becomes an automatic saver or provider of capital.

The reason I outline this history, which is of an individual, as I see it, and it is quite evident to all, is because I have a feeling that the capitalists, in the eyes of the Department of Finance, are just birds to be shot down, that they have no use and the sooner they are exterminated the better.

This typical Canadian cannot consume more, nor his family substantially more, after he has arrived in the fifties, let us say, and his capital can only be used to produce more for the great mass of consumers; otherwise the capital stagnates. He has been trained in the ways of capitalism, and he cannot change unless he retires and goes to pieces. So, like the bridge player he is interested in the score. He looks to continue to successfully build more and more factories, and only the great mass of the public can consume their output. It is of no value to the man who puts up he capital to have more things produced unless they can be sold. As our friends who have just left the table will agree, the only people who can consume are those in that great mass of people an labour in general. It may be that they do not get their fair share immediately, but there is no possible use in capital's building more factories and accumulating unless it produces goods for the service of our people.

This same man is likely hopeful that his son or sons will carry on from where he left off. If I may digress here for a moment I should like to mention the incidence of estate tax. This man at the age of 50 starts accumulating an estate. He passes out at 70 or so, and the Government takes 50 per cent of the value of his estate. Let us say that the business does not have to be sold entirely, but that one of the sons can carry on with the help of the bank, et cetera. The son at that time is about 45 or 50, and he has got only 30 more years until he is also in the position of having his estate pay the succession duty. It is impossible to accumulate capital from one generation to another, and it is my belief that that is inimical to the best interests of our country.

If you take away the score pad or the incentive, the game is over. Otherwise why should a successful man continue to shoulder the burdens of responsibility. He might as well retire at 50 and waste his capital. After all, the Government pays 50 cents on every dollar he spends because of succession duties.

Senator Connolly (Ottawa West): And income tax.

Mr. Jackman: Yes, indeed. Very briefly, there are the following five hurdles to the developing of a business and the formation of capital in Canada:

The first is the 50 per cent tax on company earnings which is often considered to be passed on in the price of products.

The second is the personal income tax brackets which, as we have heard this morn-

ing, are in many cases 30 per cent higher than in the United States.

The third is the virtual abolition of gifting which silently creep into the statute books a few years ago, and which is a very material matter to those who are seeking to accumulate capital and to build up Canada.

The fourth is the higher burden of succession duties, and the fifth, the proposed capital gains tax. It is as if there were some little avenue left which was not blocked, and they decided that they would take a shot at that, and then the bird would finally be brought down.

The Chairman: Mr. Jackman, in a discussion that I had recently with people who may be appearing before the committee, it was assumed that when a man died he had $100, and the point was made for every $100 he had there would be a net of $36 left. The person I was talking to was trying to correlate this to how the business which he had developed could be carried on. He concluded, of course, that it could not be carried on, and that the answer was to get out of business before he died.

Mr. Jackman: I do not know whether that would help him very much, but I suppose he gets $36 by reason of the imposition of the estate tax, and there is the necessity of selling the business or part of it in order to get the money to pay the estate tax. At that time the capital gains tax becomes effective. Later on I shall have an illustration of just what happens there.

I might say that as a matter of interest as well as amusement I attended the large meeting organized by Bullock and his associates, and one of the chartered accountants on the panel suggested that the man who had a house with a very large appreciation to it would pay a total of 136 per cent through the estate tax and the capital gains tax. One of the members of Parliament who happened to be in the audience rose and said that that was quite wrong; that that man would not have to pay more than 100 per cent. I must say that he did not get very much support from the audience. It is amazing to see just what the incidence is that some of these figures produce.

I was suggesting, Mr. Chairman, that the fifth hurdle that one had to get over would now be the capital gains tax, if one was seeking to raise money to develop the country. The need for development capital in Canada is so great that I am sure the members of this honourable committee will not require proof. One has only to walk through a steel mill to realize the huge capital investment there is behind each worker.

The other day I saw a photograph of a large B.C. fir being felled. It was approximately twelve feet in girth. It was felled by a chain saw which I suppose cost only $500 or $600. That chain saw was doing the job in a matter of minutes, while it would have taken a couple of men with their axes a matter of hours.

I am only pointing out what capital does in the way of producing goods and services for all the people. The implication is that capital is entitled to some reward, and it should be allowed to replace itself through depreciation, and to grow with the needs of the country.

I feel a certain amount of boldness in coming out for capital as I do, but I see no reason why I should not. It is my firm belief, and these are the principles upon which I have operated myself during business life. Instead of feeling dissident about supporting our system, I am firmly and enthusiastically behind it for what has done for Canadians and for the Western world.

I might suggest that the amount of capital required per employee to give him materials to work with is probably about $30,000. The reason I want to bring that out just now is that if a small businessman dies leaving an estate of $300,000, it is in the 50 per cent estate tax brackets, and it may be a shop that employs only ten people, which is very, very small in this modern age. So, this estate tax business must be brought down to lower levels.

On the other hand, in respect to interprovincial pipelines, it takes a $1 million of investment to provide work for one employee. Canada is a capital intensive country because of the nature and extent of its resources.

I see no evidence that the authors of the White Paper wish to distinguish between consumer capital and producer capital. I am concerned only with the former. The rate of capital formation is perhaps the most important factor in determining the rate of growth of a country's economy.

In one of your previous sessions, Mr. Chairman, a gentleman pointed out that some $650 million would be extracted from the economy each year. I believe it was Senator Molson who pointed out that $100 million left in the

economy would be better than some billions of dollars of structural development.

The Chairman: That was Senator Phillips.

Senator Connolly (Ottawa West): Senator Molson agreed with him.

Mr. Jackman: I felt I was not too far wrong. It is common knowledge that last year Japan's gross national product became the second largest in the world, surpassing that of Germany. Over the period 1960-68 the savings ratio to GNP growth rate are illustrative. The savings ratio in Japan in the 1960-68 period was 36.3 per cent, which is really a tremendous sacrifice for the time being. However, it resulted in a growth rate in their whole economy of 15.9 per cent on average. In Canada we had a savings ratio of 22.5 per cent and a growth rate of 7.5. In the United States there was a savings ratio of 18.4 per cent and a growth rate of 5.5 per cent.

The point I wish to deduce from these figures is that the more one can save and invest in productive enterprises, the greater the crop will be. That is why Japan is so prosperous at the present time. A recent article in, I believe, *World News* pointed out that at the present rate of progress by the year 2000 Japan will have a higher standard of living per individual than the United States of America. It is simply a progression of the figures, and it may well come about.

May I now refer to the estate tax, which in many cases must inevitably be associated with the proposed capital gains tax. Estate taxes are now 50 per cent on everything over $300,000. I have already mentioned the small workshop of ten men requiring an investment of $300,000, so it is no wonder that the small businessmen are up in arms.

As a more realistic example, let us consider a Canadian who employs 100 men, which is not large by modern standards. His estate may therefore be worth $3 million. His estate tax will be just under 50 per cent, or $1,432,000. He is not likely to have that amount of ready cash. You cannot live and die at the same time! That is unfortunate, because if you knew when you were going to die you could arrange your affairs, get into government securities and have them on hand. However, most of us like to live with some hope, and we carry on our business, so that when we die our executors have a little problem on their hands.

The Canadian employing 100 men or the estate must sell half the shares, which of course plays havoc with control. Indeed, the new buyer is likely to insist on control, because he has other places to invest his money. Therefore, our Canadian's life work, as far as he is concerned, disappears at one fell swoop. I suggest the motivation of succession is about as strong as the desire to have a family. The most likely buyer is an American if the business shows any real promise—which is anti-national.

Also at this point you run into what Mr. Benson referred to as the "double whammy". The White Paper sought to avoid the double incidence at death of a capital gains tax and the estate tax. What is the likely result? Assuming a Canadian with meagre savings builds up the business over his lifetime through hard work. Because of the increase in earnings his business had developed a future flow of income—and I underline those words, "future flow of income"—of $100,000 per annum, and that it would be valued at $1 million, or ten times the earnings. His estate tax would be $432,000. How is he or his estate going to get that amount? A sale is likely to be the only way, at which point capital gains tax of 50 per cent applies. Whether it is coupled with the estate tax or not, if you are to sell at that particular time you will have to pay the capital gains tax.

To raise the money the business is sold for $1 million, the original investment being nothing but hard work, brains and character to borrow from the bank, to say nothing of the earnings ploughed back year after year, on which 50 per cent corporation tax has been paid regularly. The capital gains tax amounts to $500,000, leaving the estate a net amount of $1 million less the $500,000, less the $432,000 estate tax. In other words, there is left in the estate after the two taxes, as the Chairman asked me a little earlier, an amount of $68,000.

The ground rules are too svere for a young man to want to play in this game. The young men are not going to stay in Canada. The authors of the White Paper seem bent entirely, like Legois in Les Misérables, on exterminating the evils of the capitalist class. Wherever the team of Benson, Boyce and Brown have seen anything that looks like an accumulation of capital or the means of building a business they have set themselves out relentlessly to exterminate it root and branch. From such actions we must surely imply that as capital must be forthcoming from somewhere, the state, through the Canada Development Corporation, or in

Quebec the General Development Corporation, etc., will supply it. We will certainly not increase the standard of living of our people unless we increase our production, and that requires capital. If the state is the only source, if that is not socialism or communism and farewell to freedom, it must be the same thing under a different name. I think the Canadian people are unalterably opposed to such a social and economic revolution.

The difficulty is that, as an historian once observed, the people are scarecely aware when a great revolution is taking place. It was that way with Hitler. It has been that way many times in history. People in general are not aware of what is taking place. Thankfully, we have great legislators and great leaders in this country. Those of us who actively oppose the White Paper feel that we more genuinely, and certainly more correctly, have the general welfare of all Canadians at heart than have the authors of the White Paper.

I am reminded of Earl Russell's answer to the question whether he considered Karl Marx a philosopher. His answer was No, because Marx was more interested in pulling down the bourgeoisie than he was in raising up the proletariat. Therefore, in my humble opinion, I do not consider the Department of Finance to be philosophers.

The Chairman: What about being economists?

Mr. Jackman: Since you ask me the question, I am not going to rate them too highly as practical economists.

Of course the state must have revenues, and the welfare of the people must be the first consideration. The point is that unless we increase our productivity by encouraging capital investment we are going to have a very small base to tax or pie to divide. Capitalism does not ask of others, but only asks for the opportunity to provide a much greater total of which it asks but a very small competitive share, otherwise capital would stagnate.

In the *Globe and Mail* yesterday there appeared figures for the United States covering the last quarter of 1969, showing that manufacturers earned 4.6 per cent on sales, and that was to cover the full return on capital as well as anything ploughed back for expansion of the business. It seems to be a modest return. Believing that Canada needs private capital if it is to increase the welfare of its people and at the same time needs revenue, I am not so concerned where the burden of taxation falls so long as there is some opportunity for capital to be created and accumulated. The last avenue of creation is not to be closed by the capital gains tax, but it might be considered a not too injurious set-off if the estate tax were abolished and the capital gains tax introduced.

I have had no opportunity of even endeavouring to form a judgment on that, but I think some outlet must be allowed for the accumulation of capital, if we are to progress in this country or in any other country.

In view of the apparent political desire to have Canadians own Canada, I offer this illustration of what the estate tax is doing to Canadian ownership relative to U.S. or foreign ownership. It is commonly said that 80 per cent of our petroleum industry is American-owned, and 65 per cent of our mining industry and 45 per cent of our manufacturing industry. If we take an average of 60 per cent, then 40 per cent remains to Canadians. We should assume that both segments grow equally over the years. All foreign ownership is excluded from estate taxes in Canada and most of it is in the hands of foreign corporations that never die anyway. Only the 40 per cent owned by Canadians is subject to estate taxes. The result is that 40 per cent ownership in Canada becomes 20 per cent on the first passing of the estate, because it is a 50 per cent etate tax that is applicable. The shares may be purchased by another Canadian. That is true, but half the original owner's capital is lost in taxation. After another 30 years—a generation—the same operation is continued and the 20 per cent ownership of the Canadian major resources, anyway, becomes 10 per cent. As there will be no pools of Canadian capital left to purchase, more and more of the ownership of Canadian industry will pass into American—and I have now added Japanese—hands. The amount of revenue derived from estate duties is relatively little and both from the consideration of growth as well as Canadian ownership the estate duties might well be eliminated.

I should like to make a few observations about the nature of the capital gains tax. As one who loves Canada I am against such a tax at the present time at least. But the people seem to be willing to accept it because the United States has a minimum 25 per cent rate operative only at the time the assets are sold,

Our proposed rate is 50 per cent, except for shares in publicly-held companies. The five-year revaluation rule is, I humbly suggest, preposterous to a businessman, and I am sure honourable senators do not want that matter belaboured. The inclusion of homes and personal possessions would make it appear that the tax collectors' forte is leaving no place unprobed. Where works of art are being collected as a substantial store of value, suitable provisions can no doubt be provided. Where the tax might amount to anything, the invasion of one's privacy and the necessary bookkeeping is beyond belief. I believe it to be an invasion of privacy which should not be tolerated in a free country.

The main consideration, however, is an examination of what constitutes capital. It is a store of value, money that one has earned and then saved and then invested. If it appreciates, it is not because something has come out of others but rather because the capital was usefully employed and produced earnings. Those earnings in the practice of the market are capitalized because the company is a sound enterprise, and the earnings will continue or may even expand. Where the money comes from that represents the capitalized value has always been a bit of a mystery to me, but certainly it does not come out of the people, except inasmuch as it represents a hope for return for goods and services to be rendered in the future. Thus, the best definiton of an investment is a future flow of income.

An investment is a future flow of income; that is what you buy when you buy an investment, whether it is a Government bond or shares in a uranium mine. You are buying a future flow of income.

If a Canadian sells his shares to another Canadian, the Government will continue to get his tax on those same earnings.

Senator Cook: You hope.

Mr. Jackman: But in someone else's hands. There is no change so far as the Government is concerned. Taxing this flow of earnings when X owned it and taxing the same flow of earnings when Y owns it, makes no difference to the Government. There is no change. They are getting the same amount of money. But what the capital gains tax seeks to do, once the earnings are capitalized through a sale, is to tax that capitalized future flow, even though it is going to tax the same earnings as before but in the hands of the new owner. In other words, it is going to tax the flow of earnings just as before but they want to tax the capitalized value of it. It seems very difficult that you should both have your cake and eat it, which is what the Government is doing.

The Chairman: You mean the capitalized value...

Mr. Jackman: That is the cake.

The Chairman: That is reflected in the gain as a result of the sale.

Mr. Jackman: Yes, but the value is there because he had an earning power, you see. The company had an earning power.

The Chairman: I am not raising that point. What I am saying is that the element the capital gains tax goes after is the gain that has occurred since valuation date. That is the element to be taxed when there is a sale of a share, for instance.

Mr. Jackman: That is quite true. That is the element. That element represents the capital value of the future flow of earnings, which is still continuing.

The Chairman: Quite. I was not looking at that end. I was looking at it this way. They are not doing the other thing which you said, namely, taxing the capitalized value realized on the sale. They are taxing the element in that capitalized value that represents a gain enjoyed after valuation date.

Mr. Jackman: That would be the way it will work if we have a V-Day.

The Chairman: You still get your return of capital.

Mr. Jackman: That is quite true. I don't know whether it takes away from the point that I am endeavouring to make, however.

The Chairman: It is just putting it in the right context.

Mr. Jackman: Yes. You are correct, sir. In other words, the same earnings are taxed twice. What actually has happened is that there has been a capital levy and that much less capital is therefore available for investment in Canada.

Perhaps a rather personal example will illustrate the economics of the situation. The Government subjects senators' indemnities to taxation, because they are part of earned

income. Now, suppose senatorships were transferable, there would be a ready market.

Senator Beaubien: Are there any bidders?

Mr. Jackman: And suppose one was sold for $200,000. The White Paper proposes taxing that amount at 50 per cent, or a tax of $100,000, but at the same time the new senator would be paying tax on the senatorial income as before, which is the point I am endeavouring to make. The Government would not only continue to get the same taxes as before from the new senator, but at the same time it would have taken half the capital out of production.

The sale of a business follows the same principle. The Government loses nothing in taxation, but it taxes the opportunity of making a capital levy. There is, therefore, less capital for investment.

Foreign ownership is hit very hard in the White paper by making any capital gains taxable at an effective 50 per cent or double the rate on shares of publicly held Canadian companies. I might say that the present tax provisions add 4 per cent tax on income from foreign sources. If I may digress here for a moment, I should like to point out that at one time all foreign investment income was taxed 4 per cent above your maximum rate. When your maximum rate got to 65 per cent or 75 per cent, and you had only 25 per cent left, 4 percentage points off that represents a rather substantial tax. So, in the wisdom of the legislators during Mr. Fleming's term as Minister of Finance, they took 4 per cent off Canadian investment income, but because there was some slight stringency on foreign exchange at that time they left it on all foreign investment income. However, there has been no concern given to the fact that in the meantime we have no longer any shortage of foreign exchange, and the tax remains, which is another point I make in my criticism of the Department of Finance. They have no regard whatsoever, even beyond the needs of necessity to raise money, for the position of the taxpayers in this country. I think there should be a few practical businessmen and some taxpayers put into that department, to have them give some consideration to the people of Canada.

The Chairman: All the people who are in the Department of Finance are taxpayers, are they not?

Mr. Jackman: I think we could take judicial notice of that, sir. As I shall illustrate a little later on in connection with a small matter, they are not always aware of what is going on or what the difficulties of the taxpayers are.

Another aside, if I may: In the financial business one has to spend so much time thinking about taxation. Everything you do is based on whether it is right or wrong, mostly because of technicalities and not because one is scheming to do anything; and the Department of Finance has not seemed to want to do anything to lessen the burden which takes so much time away from efforts which might otherwise be productive. It is impossible to constrain substantial amounts of capital; you cannot put them in a strait jacket. On the one hand, the Department of Finance cannot make Canada an attractive field for investment and at the same time force Canadians to invest in their own country. Capital is too fearful and too mobile.

Why should Canadians be penalized for investing in what Japan are sometimes termed "sunrise" industries rather than "sunset" industries? For example, Canada has little or no aerospace, airplane, drug, electronics, business machines, petro-chemical, photography, radiation industries, and so on. We are to be denied that unless we suffer a double rate of taxation as compared with investing in Canada.

Why should a Canadian be forced to invest in, let us say, bank shares in Canada which sell at 20 times earnings, when you can buy bank shares in Japan at seven times earnings? Why should a Canadian be denied the right or pay a 50 per cent penalty to buy shares in a group of insurance brokerage companies in London when he can buy them for less than half what he would pay in Canada or the United States? I just do not think these boys in the Department of Finance have very much understanding of the implications of business and the problems businessmen are up against and the specialized knowledge which each one must have in order to run a successful show.

It is impossible for anyone to invest in all the promising situations at home because they are not known to him. At the same time, he may have specialized knowledge of certain situations in the foreign market, perhaps because he understands only certain industries, irrespective of where they are located. There is much evidence in the White Paper of little or no understanding of the world of business.

I should also like to call the attention of the honourable committee to paragraph 3.4 on page 36 of the White Paper. The immaturity of the Department of Finance is incredible. It suggests, where it is trying to justify capital gains as income, that profits not paid out go to increase the surplus and that surplus, therefore, increases the value of the shares. What constitutes value of the share is times earnings at which it sells in the market place, not some surplus which has been accumulated.

I recall the case of the American Express Company which settled the unfortunate "salad oil" scandal by paying out, I believe, $50 million or more, but it had no effect on the price of the stock because the earnings of the company were not substantially affected.

It would appear that the Department of Finance maintains no connection with the outside business world, the men of affairs who take risks, borrow and invest their own capital. Apparently, this ivory tower complex has persisted for many years, for I can well recall the Right Honourable Mr. Ilsley saying that while businessmen understood their own business they could not be relied upon to see the general welfare of the country as a whole. I repeated this to another former Minister of Finance, the Honourable Charles A. Dunning, and he was amazed, for he said that whenever he had a problem which affected a particular industry he would always call one or two of his friends on the telephone to come up to Ottawa to discuss the effect of the proposed legislation, and not once did he have his confidence violated. Recently, from what I read in the newspapers, Mr. Benson was lamenting the fact that he could not be in contact with businessmen to find out what the incidence of certain proposed legislation might do. I can only suggest that the effort made was not very great.

Indeed, one wonders if the Department of Finance has the slightest concern for the citizens of this country, for the virtual abolition of gifting has closed one of the avenues of family capital accumulation. I had occasion to read the supporting paper which was prepared for the Royal Commission on Gifting. It was written by a lawyer and an accountant. Its sole attempt was to equate gifting with the estate taxes, but nowhere in it was there the slightest reference to the age of the donor. It naturally makes a great difference whether one pays a tax at age 40 or at age 60 to offset an estate tax which would not ordinarily become exigible until the donor was, let us say, 70 or 75 years of age. I think these figures are correct. In effect, the rate of tax would double—that is, if you paid gift tax at age 40 or so—every seven or eight years from the date of payment, so that a tax of 15 percent paid by a man at age 45 would be equivalent to paying a tax of 120 per cent at 75 years of age. No reference was given in this supporting paper, on which the Department of Finance bases its recommendations, to the age of the donor. Of course, that is of terrific consequence.

Furthermore, on the small gift allowance of $2,000 annually which can now be given, having been raised from $1,000, to an individual, the income under the existing legislation is attributable to the donor and taxed in his bracket until the child is nineteen.

I suggested, now that any substantial gifting is prohibitive, that possibly the Government would recommend that the income be allowed to go directly to the person under nineteen. Surely, one of the main purposes of the $2,000 gift allowance is for a parent or grandparent to build up an educational fund for a child or grandchild, but as the law now stands any income must be taxed in the hands of the donor.

I was infomed that the department was not aware of this provision, and I was very sorry to see that it was not rectified. But, in the Department of Finance who cares, even though the small example I have given must be of concern to many thousands of taxpayers?

The Chairman: Mr. Jackman, in a gift to a wife there is no tax in the lifetime.

Mr. Jackman: Not now.

The Chairman: But under the Income Tax Act the income which the wife may receive from that gift is income that is attributable to the husband, and the husband pays tax on it.

Mr. Jackman: I would not have the slightest doubt about it, sir, but gifting used to be the most useful outlet for building up capital, particularly if one started early enough in life and gave seed capital to one's children. It is getting to be very difficult, and I think that many accumulations which have taken place will not now be possible under the proposals in the White paper.

My thesis is, of course, that if you do not have capital you cannot have progress in this country.

The Chairman: Of course, they can move to Alberta where they get their federal tax back from the province.

Mr. Jackman: That is in the case of death. As I said, it is very difficult to die and live at the same time—but some of us are still hopeful.

When you can only give $2,000 away surely you can give it to a child and let the income accumulate in the child's portfolio, if you like, until the child is 19 when he gets the income anyway.

Just as a matter of interest, gentlemen, as some of you know, I had the great pleasure of once living in these halls. We were going over the Income Tax Act, and Mr. Douglas Abbott was the chairman of the committee. The provision used to be that you could give to a child but the income would be taxable in your hands until the child was 18, but the minister could disallow it until the child was 21. Mr. Abbott suggested that we do away with the ministerial discretion and make it 21. I said to him: "That is worse than it is now, because the minister never does that." He said: "We will comprise and make it 19". I agreed, and that is why it is 19 in the statute books now.

Surely, if the Department of Finance has any concern for our taxpayers it would allow them to give $2,000 to a child under 19, and let the money accumulate so that the child would have at least enough for an education, or perhaps to obtain a start in life.

It is a very small matter. I am not naming names, but high officials did not know that the income was attributable to the donor. Subsequently they have had a budget, and they have been looking at it. One gets a little cross with the Department of Finance, but it does not do any good.

The Chairman: I do not think so. Being cross is not rationalizing.

Mr. Jackman: The White Paper aims are tax reform which embraces directly or indirectly almost our whole system of taxation. The key note of integration of corporate and personal tax, while it has some virtues, has also many faults, particularly in regard to the development of the country. The provision where a taxpayer receiving a dividend on his shares would be allowed to credit the percentage amount of tax paid by the corporation so that his personal rate would be reduced, is very bad from the point of view of Canada's development.

At first blush, when the White Paper came down, it seemed that this was a very reasonable objective. You will all recall that many stocks on the exchange went up three or four points. Old established companies that pay the 50 per cent tax rate on their earnings would be much better investments for Canadians, because the investor gets a creditable rate, as I am sure you gentlemen know.

The Chairman: Yes.

Mr. Jackman: Old established companies that pay the 50 per cent tax rate on their earnings would be much better investments for Canadians than would growing capital-needful companies which do not have any established taxable earning power. In the former case the shareholder would be allowed to credit 50 per cent of the tax paid by the corporation against his own tax, whereas the shareholder in the growing company would not have such a high, if any, credit to apply against his income tax.

In other words, it favours fully developed companies, as against companies which are developing new ideas, or even resource companies that are not in a position to pay out dividends.

For Canada and the Canadian people it is a great handicap, as can be seen by reference to Senator Aird's chart to which you alluded a little while ago, that there are only 1,145 taxpayers whose incomes are $100,000 and over, at which time the tax is between 65 and 70 per cent.

I should like to suggest that in the chart which is at the back of the particular volume of this committee's proceedings, the straight line on the Aztec temple is a misrepresentation, because it is not possible to put into print a hairline so fine as to represent these 1,145 taxpayers. The point that I wish to make is that when there are so few people with large incomes in Canada we are not going to atract young men from other countries. Here I am thinking of graduates from the Harvard Business School who start off at $12,000 and $15,000 a year. It was $1,200 in my day. They all have their wagons hitched to a star, and they will look at us and say: "Well, there are only this many wealthy people in Canada. That is not much of a field. What is wrong? Is it the resources of the

country, is it the people, or is it the tax structure." In other words, if you do not give big prizes you will not get many people playing bingo. Let us provide education for those able and willing to absorb it and equal opportunity for all.

It is not difficult to understand the reaction of the small businessman to the taxation measures that have been suggested. It is almost an emotional reaction, because he feels he will be hurt and will not be allowed to grow. If the standard of living of all the Canadian people is to be raised, it will only come through the investment of capital. Do we want socialism and communism or do we want free enterprise and capitalism? You cannot have capitalism without capitalists. The greatest service that Parliament can do, in my humble belief, for the people of Canada is to foster and encourage capitalism the creator. Thank you, gentlemen.

The Chairman: Thank you very much, Mr. Jackman.

Senator Beaubien: Mr. Jackman, you cited the case of a man dying and leaving a $1 million business. Would you go over that equation again where he ends up with $68,000?

Mr. Jackman: He has a $1 million business. When he dies, in estate taxes he pays 50 per cent on everything over $300,000, so I think it works out at $432,000. If he knew he was going to die and had a bundle of government securities in his box he would be all right.

The Chairman: He would be all right in the second sense, because he would have no capital gains as it is now.

Mr. Jackman: The minister did not want to bring in the "double whammy", to use his words, of capital gains and estate taxes at the same time, but you have the $432,000.

Senator Beaubien: To pay out.

Mr. Jackman: To pay out anyway on estate tax. It is wanted now. Where are you going to get it? Either you or the estate will probably have to sell something, unless you have a lot of other assets. I suggest that this man has been devoted to his business and ploughed back his money into it, built it up and given employment in the town, made a real contribution to the life of the country. Someone, he or the estate, has to sell the business. As I suggested earlier, when I gave the description of what I call the "economic man", he starts with nothing but some knowledge, ability and character to get credit from the bank, ploughs back his earnings, so he had no capital in it really, and half the $1 million he gets for the company is lost to capital gains tax, namely $500,000.

Senator Beaubien: Surely they could not both apply.

The Chairman: Let us assume he has to sell the business and gets $1 million for it. What would be taxable would be the value added since valuation date. Therefore, you cannot go back as far as Mr. Jackman is talking about, when he started with just his brains and know-how.

Senator Beaubien: You are in the future.

The Chairman: In the future, but not today, because of valuation date.

Senator Beaubien: In Quebec there is the fantastic example of Bombardier, which five years ago was worth nothing and now has 15,000 shares selling at $20.

The Chairman: You only start applying capital gains tax as from valuation date. Are there any other questions?

Mr. Jackman: I do not know whether the committee would be interested in the year-end indices of leading stock markets since 1960. I did not want to touch on too many points this morning, but it appears to me that the capital gains tax, if implemented, may not be quite as productive as desired. Perhaps I could table that.

The Chairman: Very well.

Appendix "B"

The Chairman: Are there any other questions?

The committee adjourned.

APPENDIX "A"

Submission by the
Canadian Labour Congress

to the

Senate Committee on Banking, Trade and Commerce

on the

Government White Paper entitled
"Proposals for Tax Reform"

April 9, 1970
Ottawa

Mr. Chairman and Members of the Committee:

1. The Canadian Labour Congress, the main Canadian central labour organization, with a membership of over 1,600,000, welcomes the opportunity to appear before you to express its views on the proposals contained in the Government's White Paper on Tax Reform. We appreciate the fact that a Parliamentary Committee was given the task of hearing representatives of various groups and organizations comment on a document which is of great importance to all Canadians. The subject of taxation, and in particular the way in which the burden of taxation is distributed, is of major concern to everyone.

2. We welcomed the appointment of the Royal Commission on Taxation (the Carter Commission) in 1962, and we were very much impressed with the thorough analysis of the existing tax structure undertaken by that Commission. With the publication of its Report in 1967, we expressed the view that the Report, on the whole, had made an outstanding contribution in showing how a much more equitable tax system could be effected in Canada.

3. While we disagree in a number of respects with the White Paper, as we shall indicate further on, we believe that the White Paper, in general, has also made a significant contribution in both exposing the highly inequitable tax system which we now have, and in suggesting ways in which to make the tax system more equitable.

4. The basic philosophy underlying our approach to any discussion of taxes, whether these taxes are levied at the federal, the provincial or at the municipal level, is that the distribution of the burden of all taxes, wherever possible, should be based "upon ability to pay", words which we are glad to note appear a number of times in the White Paper. In this connection, we highly commend the inclusion of the following statements in the White Paper, which well summarizes our views on what "equitable" taxation is all about:

> "Fairness in taxation implies two principles. First, it means that people in similar circumstances should carry similar shares of the tax load. But, for a variety of reasons—historical accident, outdated decisions or short-term expediency—taxpayers' circumstances are defined in ways that ignore certain forms of income and expenditures. Many of the wealthy in our society have benefited unduly. A taxpayer is understandably angry when he sees that he carries an extra tax burden to pay the cost of unfairly low taxes on others. This concept of fairness must shape the standards we apply in stating just what income is—Fairness also requires that people with higher incomes, people who are better off, should be expected to pay in taxes a larger share of their incomes than persons with lower incomes. This concept of 'ability to pay' is embodied mainly in the income tax as a progressive graduated tax having increasingly higher rates as income increases."

5. Ever since governments began levying taxes, the question of how tax burdens should

be allocated has been marked with controversy. Some have suggested that individuals who are the direct beneficiaries of government services should pay for them. But such advice is seldom practicable today. It is true that the driver of a car pays more for the cost of maintaining highways than a non-driver. The sales tax on gas makes it possible, in this case, to assess the beneficiary more directly for his use of this particular public service. But it is impossible in the case of mamy government services to determine who benefits and to what degree. Most public services are too general, and it is therefore impossible to relate the benefits of these services to specific individuals. In some cases it may be quite apparent who are the direct beneficiaries, but it may be impossible to know who are the indirect or future beneficiaries. The school child is the direct beneficiary of expenditures on education, but some unknown future employer, as well as future society as a whole, will indirectly benefit from such expenditures.

6. But even more important, the principle of forcing direct beneficiaries of services to pay for them would place severe restrictions on the provision of desirable public services. The purpose of social security, which is to help those in need of assistance, would be undermined. Security in old age would be the prerogative solely of those who could afford it. Even elementary education would be limited to those able to pay. From a humanitarian point of view, the apportionment of total costs to the beneficiaries of public services is out of the question.

7. We are well aware of highly organized campaigns whose object is to discredit the White Paper on a number of grounds. One of the charges which has been made is that the White paper has been designed to increase government revenues. While we believe firmly that government expenditures should be efficiently planned, we see nothing wrong with rising government expenditures to meet important needs of society.

8. The level of government spending has long been a subject of sharp controversy. Unfortunately, this issue often gets entangled in rigid and irrational ideological arguments. We do not see any sense in such doctrinaire statements that everything is going to "end in economic chaos", that the country is "certain to head for bankruptcy", if expenditures continue to rise. To argue that government spending is bad per se makes no more sense than to argue that there is something sacrosanct about government spending.

9. The Congress believes that a pragmatic, not a doctrinaire, approach to this matter is required. If it is necessary to expand the public sector because the need for goods and services financed by governments is growing, then there is no reason why government expenditures should not rise, even as a percentage of the gross national product. Surely the sole purpose of economic activity is to satisfy human needs. If a growing proportion of these needs must be met by public financing, we see nothing wrong with this.

10. It is our view that the only test of whether any good or service in demand should be provided through the private or the public sectors of the economy is which of these sectors can provide it most efficiently. The fact that some goods and services can best be financed through the public, rather than the private, sector has given rise to the development of our "dual" economy. We do not expect governments to provide automobiles, washing machines, refrigerators, shoes and clothing, any more than we expect the private economy to provide roads and schools.

11. Those who would put tight reins on government activities would deny society the kind of goods and services which only governments can provide and which society *wants*. Sharp reductions in government spending on goods and services for public consumption would have the effect of seriously reducing the general standard of living of Canadians.

12. Increased government expenditures on health and welfare, on education, on the development of manpower and other resources over the past years were essential, indeed indispensable, to the welfare of Canadians and to the increased growth of the economy. Rising government expenditures in the years ahead will be vital to resolving such problems as air and water pollution, to combatting poverty and privation in Canada, to solving housing problems and a host of other problems which modern urban areas pose.

13. We agree as well with the "main points to be met", as set out in the White Paper. However, as we shall comment further on, we do not believe that the White Paper's proposals, if implemented, would effectively meet a

number of these important points. These points are:

> Canadians in the lower income tax brackets face a heavy total tax burden. In recent years sales taxes and property taxes have been increased substantially. Where changes in the income tax can provide relief, it must be given to those with lower incomes...
>
> Important forms of income and benefits escape taxation. The government proposes to bring them into taxable income. In particular, a tax on capital gains is proposed.
>
> Tax can be avoided under the present law by clever devices. The reform must close loopholes now available to those with the wealth and expert advice to use them.
>
> Wage earners are unable to deduct many legitimate expenses from taxable income. New deductions would be introduced to benefit employees and working mothers.
>
> Corporations are taxed in ways that are open to abuse...
>
> The mineral industries enjoy special tax benefits that have existed for many years but that are unnecessarily costly and inefficient. Assistance to mineral exploration and development must do its intended job in a more direct way that is less costly in terms of revenue.

14. These are highly commendable points in that they effectively expose many of the inequities and inefficiencies inherent in our present tax system. But we do not believe that the White Paper would significantly alleviate the inequitable tax burden which now rests on those in the lower income brackets until it comes to grips with the most inequitable aspect of our entire tax system, namely, the general sales taxes. Indeed, the White Paper is quite candid in recognizing the highly inequitable and regressive nature of these taxes:

> "Other major tax sources in Canada should not be used in substitution for the income tax. General sales taxes are employed extensively by both federal and provincial governments and now yield approximately $4 billion. For most Canadians, they are equivalent to a combined retail rate ranging from about 13 per cent to over 16 per cent and apply to nearly all purchases except foods. They have been increased in recent years. Broadly speaking, the weight of such taxes is proportionate to expenditures and to incomes, and inferior in fairness to the graduated income tax."

15. It should be noted that the above statement underestimates the *actual* rate of sales taxes paid by Canadians. It overlooks the fact that the federal sales tax, which is applied at the manufacturer's level, results in the consumer paying more than the 12 per cent tax charged because of the pyramiding effects of the wholesale and retail markups.

16. Then there is, as the White Paper notes, "...the real property tax, levied chiefly by municipalities under provincial law. It creates revenues of about $2.9 billion per year and bears heavily on those with low incomes, if we take into account its effect on rents."

17. Thus, according to the White Paper, the combined total of the general sales taxes and the real property taxes amount to approximately $7.0 billion of the $27.6 billion which was the estimated revenues of all governments for the year 1969. These taxes, which the White Paper admits to bearing heavily on the lower income groups, make up about 25 per cent of all government revenues. (Our own calculations, based on D.B.S. data, indicate that in the year 1967, the latest published data available, general sales taxes and real property taxes accounted for about 40 per cent of total tax revenue.) Furthermore, they yield in revenue nearly 90 per cent as much as personal income taxes, or those taxes which, because of their graduated nature, can best be made equitable. As the White Paper states:

> "More than any other tax the personal income tax can be carefully adjusted to the income of the individual and the circumstances which affect his ability to pay, such as family responsibilities and unusual expenditures or expense obligations. To see that the whole tax system is fair, we must ensure that the income tax remains the main tax levied on Canadians. It should be given priority in the tax reform program."

18. These are words with which we wholeheartedly concur. But it is precisely because we agree with this policy that we find so baffling the statement, immediately following the words quoted above, that: "Reform of the sales tax is less urgent and can be undertaken after action on the proposals in this paper."

19. The proposal in the White Paper to remove or reduce taxes on certain lower income taxpayers by increasing the basic personal exemptions does not mitigate the inequity of our overall tax system since the raising of exemptions applies to all taxpayers, irrespective of ability to pay. Furthermore, while the proposed improvements in the personal income tax would lead to the elimination or reduction of taxes in the lower income brackets, the fact is that these tax savings are extremely small. The largest tax saving of $127 for a married taxpayer with two dependent children, with gross income of $4,000, is less than $2.50 per week. For other taxpayers in the same category earning under $8,000, the tax saving is even less. This can hardly be called a sweeping shift toward a more progressive personal income tax structure.

20. It is equally difficult to understand why this White Paper proposes new tax increases for those in the $10,000 to $15,000 income brackets but fails to provide for proportionate tax increases for those with higher incomes. On the contrary, a taxpayer who receives $30,000 a year will pay an increase of $35 as against an increase of $177 for the taxpayer who earns $15,000. For those with incomes over $50,000 there would, under these proposals, be tax reductions, including a tax reduction of $5,423 for those with gross incomes of $100,000. This latter reduction would result from the proposed change in the tax rate on this income bracket.

21. The White Paper's explanation for this proposed reduction is that by the time the reduction of top rates comes into effect persons with incomes in these brackets can normally be expected to have larger amounts subject to tax because of the inclusion of capital gains. There is an obvious assumption here that persons with higher incomes acquire part of those incomes through capital gains. While this is no doubt true in many such cases, there may well be a not inconsiderable number who receive all, or nearly all, of their incomes from salaries. The elimination of the higher marginal tax rates would thus provide, for such persons, an unfair advantage relative to other taxpayers. We hope that your Committee will look into this matter.

22. We are in agreement with the White Paper's proposal to abolish the present double tax rate on corporate income and to substitute a single rate of corporation tax. This would, in effect, comply with the Carter Commission's recommendation that the 21 per cent rate of tax on the first $35,000 of corporate income should be withdrawn, and that a uniform rate of 50 per cent should apply to all corporate income.

23. Because this proposal has become highly controversial in some quarters, it is perhaps worthwhile recalling the reasons given in the Carter Report for this recommendation:

> (1) "The low corporate rate does not apply to unincorporated businesses, which may have just as much or more difficulty in raising funds.
>
> (2) "An income of $35,000 or less does not mean that the corporation is owned by low-income shareholders, that it has few assets or small gross sales, or that it is new. Using the low income criterion as a means of selecting the corporations eligible for the low rate results in a situation where the incentive has little if any relationship to the underlying problem which is the inadequacy of funds for expansion because of the imperfections in the capital market.
>
> (3) "The low rate is inefficient as an incentive because it applies to the first $35,000 of corporate income regardless of the magnitude of the total income of the corporation. It thus reduces the average rate of tax for larger corporations which have no difficulty in raising capital in the market.
>
> (4) "The concession is also inefficient because it applies whether the rate of return is high or low, or whether the assets or sales of the corporation are expanding or contracting. The concession has no time limit, so there is no inducement for the corporation to expand. Indeed, as its income expands its taxes increase more than proportionately.
>
> (5) "By reducing the tax on low income corporations in perpetuity it tends to cushion the market pressures on inefficient and declining firms.
>
> (6) "The concession also creates many potential avenues for abuse. To stop the worst loopholes it has been necessary to enact elaborate provisions designed to prevent the break-up of 'large-income' companies into a number of 'small-income' companies that would each enjoy the reduced rate of tax."

24. It is quite apparent that the retention of the double corporate tax rate would constitute a major drawback to the development of a more equitable tax system. At the same time, however, we believe, as suggested by the Carter Report, that other and more effective means should be explored to facilitate the entry of new businesses into the Canadian economy. Preferential tax treatment, as well as the provision of means for enabling smaller businesses to have easier access to capital, would be of far greater benefit to such businesses than any such benefit now obtainable under the present corporate tax structure.

25. We strongly endorse the position taken by the government to tax capital gains. We regard this as a major step—indeed an indispensable step—to making the overall tax system more equitable. We thus fully agree with the statement made in the White Paper that:

> "A Canadian who is able to realize a substantial stock market profit or real estate gain clearly has an increased ability to pay; he is better able to pay for a new car, or to pay for stocks and bonds, or to pay income taxes, than is his neighbor who has not had such a gain."

26. The Carter Report used much the same language in recommending a capital gains tax. It is a well-established fact that, because of the present lack of such a tax, there are those who acquire a considerable proportion of their total income through capital gains which, under the present law, is exempt from any taxation. This has been one of the striking, indeed glaring, inequities of our tax structure. The government is to be commended for at last moving in the direction of eliminating this inequity.

27. We would urge, however, that in the case of those properties which were held for personal use and enjoyment and subsequently sold for a profit, the valuation procedures would be designed in such a way that the privacy of the taxpayer would be of the utmost consideration. Undue invasion of privacy for the purpose of ascertaining the value of such personal assets would undermine the dignity and the rights of individuals, and in the end could defeat the objective of making a capital gains tax fully effective.

28. We are not impressed with the argument used in some quarters that the adoption of a capital gains tax need discriminate against less developed regions in Canada. Our tax structure should not contain inequities for the purpose of accommodating specific economic needs, when those economic needs can be met, both equitably and much more efficiently, by tax preferential treatment and by other devices to provide effective incentives to economic development in those regions and areas lagging in growth.

29. But in its proposal to tax capital gains realized on the sale of stocks, there is one point which we would like clarified. The White Paper draws a distinction between "closely-held" corporations (primarily private companies) and "widely-held" corporations (public companies) for the purpose of taxing gains on shares. In the case of "closely-held" companies, gains on the sale of shares of these companies would be fully taxed (and losses fully deductible), but in the case of "widely-held" companies, share-holders of these companies would include only-half of their gains on the sale of such shares in their taxable income. This is a departure from the recommendation of the Carter Commission which urged that *all* capital gains should be taxable. It is our view that this distinction between private companies and public companies, for the purpose of applying a capital gains tax, vitiates the principle of equity. We hope that this matter will be carefully looked into by your Committee.

30. We support the White Paper's proposal that, in general, capital gains on the sale of homes would not be taxed. No barrier should stand in the way of home ownership. The proposal that when a taxpayer sells his principal residence only the profit in excess of $1,000 per year of occupancy would be taxed impresses us as being reasonable. We also approve of the proposal that a taxpayer who moves from one area to another within Canada in connection with a change of job should be permitted to treat the sale of his home and the purchase of a home in the new area as a non-taxable transaction. The buying and selling of houses for personal use, or for the purpose of aiding mobility in job changes, should be treated differently for tax purposes from that of the real estate broker, who makes a business of buying and selling houses.

31. We welcome the proposal to permit the deduction of child care expenses by working parents. This proposal, which is long overdue, finally recognizes the principle that women with children should have the opportunity of participating in the labour force. At the pres-

ent time, however, the desire for employment on the part of many women may be diminished by the fact that they find the cost of child care exorbitant in relation to potential earnings. In other words, women who would otherwise seek jobs either to supplement the family income or to find creative outlets in employment are often discouraged from doing so because of the expenses involved in providing care for their children. Child care expenses also constitute a particular hardship for women who are the heads of families, and who have no choice but to work. For all such women, no more practical words can be found to justify the expenditures of child care for tax deductions than those contained in the White Paper which state that these expenditures "constitute a real cost of earning income."

32. We are happy to note that the government is now prepared to recognize the principle that employee expenses should be deductible for tax purposes as has long been the case for business and professional expenses. However, the proposed 3 per cent deduction with a maximum of $150 for employment expenses falls short of what is required by many categories of workers whose outlay is much greater for such items as special clothing and replacement of tools. The Carter Commission, in our view, was much more realistic in recommending a $500 maximum deduction for this purpose.

Respectfully submitted on behalf of the Canadian Labour Congress by:

Donald MacDonald
President

Joseph Morris
Executive Vice-President

William Dodge
Secretary-Treasurer

Jean Beaudry
Executive Vice-President

APPENDIX "B"

UNITED FUNDS CANADA—INTERNATIONAL LTD.

YEAR-END INDICES OF LEADING STOCK MARKETS SINCE 1960
(Year-end 1960=100)

	1961	1962	1963	1964	1965	1966	Jan. 31 1967	Jan. 31 1968	Apr. 30 1968	July 31 1968	Sept. 30 1968	Dec. 31 1968	July 31 1969	Oct. 31 1969	Nov. 14 1969	Dec. 31 1969	Jan. 3 1970
Toronto	118	115	127	153	156	131	140	145	148	153	163	175	156	168	175	172	164
New York	119	106	124	142	157	127	138	139	148	143	152	153	132	139	138	130	121
Stockholm	97	89	112	130	141	111	120	124	137	158	155	171	183	181	181	183	171
Brussels	111	105	116	117	106	81	81	93	96	98	101	100	104	104	103	101	102
Amsterdam	112	97	104	108	96	82	88	105	107	113	123	124	111	129	131	126	124
London	100	93	107	96	97	89	91	122	134	135	140	147	106	105	111	116	117
Paris	121	118	97	93	85	74	72	90	99	86	91	76	86	98	95	99	102
Tokyo	98	105	90	90	107	107	108	98	108	119	136	127	136	158	159	175	171
Dusseldorf	89	69	75	78	74	55	58	82	87	91	90	89	90	99	103	98	91
Milan	108	95	82	56	67	70	70	65	66	65	65	66	70	79	79	74	77

Queen's Printer for Canada, Ottawa, 1970

Second Session—Twenty-eighth Parliament
1969-70

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE
ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 16

WEDNESDAY, APRIL 15th, 1970

Tenth Proceedings on the Government White Paper, entitled:

"PROPOSALS FOR TAX REFORM"

WITNESSES:

(For list of witnesses see Minutes of Proceedings—Page 16 : 5)

"A"—Brief from Maple Leaf Gardens, Limited.
"B"—Analysis of Appendix "A" by Senior Advisor.
"C"—Brief from Canadian Arena Company.
"D"—Analysis of Appendix "C" by Senior Advisor.
"E"—Brief from Executive Council, Canadian Chamber of Commerce.
"F"—Analysis of Appendix "E" by Senior Advisor.
"G"—Brief to H. of C. Committee by Prince George Chamber of Commerce.
"H"—Brief from Canadian Dental Association.
"I"—Analysis of Appendix "H" by Senior Advisor.
"J"—Brief from St. John's Cemetery on the Humber.
"K"—Analysis of Appendix "J" by Senior Advisor.
"L"—Brief from Canadian Association of University Teachers.
"M"—Analysis of Appendix "L" by Senior Advisor.

21821—1

THE STANDING SENATE COMMITTEE ON
BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aseltine	Desruisseaux	Kinley
Beaubien	Everett	Lang
Benidickson	Gélinas	Leonard
Blois	Giguère	Macnaughton
Burchill	Grosart	Molson
Carter	Haig	Phillips (*Rigaud*)
Choquette	Hayden	Walker
Connolly (*Ottawa West*)	Hays	Welch
Cook	Hollett	White
Croll	Isnor	Willis—(30)

Ex officio members: Flynn and Martin
(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

"With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intituled: "Proposals for Tax Reform", prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

"With leave of the Senate,

The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Hayden:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative."

21821—1½

Extract from the Minutes of the Proceedings of the Senate April 15, 1970:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Smith:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit while the Senate is sitting today and that Rule 76 (4) be suspended in relation thereto.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative."

ROBERT FORTIER,
Clerk of the Senate.

MINUTES OF PROCEEDINGS

WEDNESDAY, April 15, 1970.
(21)

MORNING SITTING

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to further consider:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Hayden (*Chairman*), Beaubien, Blois, Burchill, Carter, Connolly (*Ottawa West*), Cook, Croll, Desruisseaux, Flynn, Everett, Gélinas, Haig, Hays, Hollett, Isnor, Kinley, Lang, Leonard, Molson, Phillips (*Rigaud*) and Welch—(22).

Present, but not of the Committee: The Honourable Senators Aird, Bourget, Laird, Methot, Smith, Sullivan and Urquhart—(7).

In attendance: Arthur W. Gilmour, Senior Advisor; Alan J. Irving, Legal Advisor and Roland B. Breton, Executive Secretary.

The following witnesses were heard:

Maple Leaf Gardens

Mr. G. E. Mara, President;
Mr. R. E. Giroux, Controller.

Canadian Arena Company

Mr. J. D. Molson, President;
Mr. H. W. Hamilton, Vice-President and General Manager;
Mr. Sam Pollock, Vice-President and General Manager (Club de Hockey Canadien)
Mr. H. H. Stikeman, Q.C., Counsellor.

Canadian Chamber of Commerce

Mr. D. N. Byers, Chairman, Executive Council;
Mr. G. L. Demers, Q.C., Second National Vice-President;
Mr. R. K. Carty, Vice-Chairman, Executive Council;
Mr. F. S. Capon, Chairman, Tax Reform Committee;
Mr. H. P. Crawford, Member of Tax Reform Committee;
Mr. G. W. Riehl, Member of Tax Reform Committee;
Mr. W. J. Hulbig, Member of Tax Reform Committee;
Mr. O. Tropea, Member of the Tax Reform Committee;
Mr. C. H. Scoffield, General Manager;
Mr. W. J. McNally, Secretary, Tax Reform Committee and
Mr. L. P. Kent, Member of Tax Reform Committee.

At 12:25 p.m. the Committee adjourned.

AFTERNOON SITTING

2:15 p.m.
(22)

At 2:15 p.m. the Committee *Resumed.*

Present: The Honourable Senators Hayden (*Chairman*), Beaubien, Blois, Burchill, Carter, Cook, Everett, Gélinas, Haig, Hays, Hollett, Kinley, Lang, Leonard, Molson and Welch—(17).

Present, but not of the Committee: The Honourable Senators Laird and Phillips (*Prince*)—(2).

In attendance: Arthur W. Gilmour, Senior Advisor; Alan J. Irving, Legal Advisor and Roland B. Breton, Executive Secretary.

The following witnesses were heard:

Canadian Dental Association

Dr. W. J. Spence, President-elect;
Dr. Henri Brouillet, Past President;
Dr. H. N. Beach, Chairman of the Sub-Committee on Taxation;
Dr. W. G. McIntosh, Executive Director and
Mr. M. L. O'Brien, Lawyer.

St. John's Cemetery on the Humber

Mr. M. Dunsford, President and
Mr. E. D. K. Martin, Director.

Canadian Association of University Teachers

Prof. K. F. Byrd, McGill University and
Mr. E. J. Monahan, Executive Secretary.

Ordered:—That the documents submitted at the meeting today be printed as appendices to thesse proceedings, as follows:

A-Brief from Maple Leaf Gardens, Limited.
B-Analysis of Appendix "A" by Senior Advisor.
C-Brief from Canadian Arena Company.
D-Analysis of Appendix "C" by Senior Advisor.
E-Brief from Executive Council, Canadian Chamber of Commerce.
F-Analysis of Appendix "E" by Senior Advisor.
G-Brief to H. of C. Committee by Prince George Chamber of Commerce.
H-Brief from Canadian Dental Association.
I-Analysis of Appendix "H" by Senior Advisor.
J-Brief from St. John's Cemetery on the Humber.
K-Analysis of Appendix "J" by Senior Advisor.
L-Brief from Canadian Association of University Teachers.
M-Analysis of Appendix "L" by Senior Advisor.

At 4:30 p.m. the Committee adjourned to the call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Ottawa, Wednesday, April 15, 1970.

The Standing Senate Committee on Banking, Trade and Commerce, met this day at 9.00 a.m. to give further consideration to the White Paper entitled, "Proposals for Tax Reform".

Senator Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: Honuorable senators, we have a series of briefs this morning. The order in which I propose to proceed is to call the Maple Leaf Gardens Limited and the Canadian Arena Company. Following them will be the Canadian Chamber of Commerce, the Canadian Dental Association, the Canadian Association of University Teachers and the St. John's Cemetery on the Humber.

We may very well not finish by a quarter to one and the idea is then that we would adjourn until 2.15 p.m. The Senate meets at two o'clock and at that time there would be a resolution to permit us to sit while the Senate is in session. Then we would meet here and go ahead with the hearings. We have given a date, today, for these people and so far as your chairman is concerned they are going to be heard today, having been invited.

Appearing for Maple Leaf Gardens Limited is Mr. G. E. Mara, the President, and Mr. R. E. Giroux, the Controller. This represents the panel in the first submission.

Mr. G. E. Mara, President, Maple Leaf Gardens Limited: Gentlemen, I would like to say that I appreciate the opportunity of being here and also very much appreciate the fact that Toronto is ahead of Montreal for the first time in a long time.

The Chairman: Without scoring a goal.

Mr. Mara: Without scoring anything.

Senator Croll: But you are behind the eight ball as far as hockey is concerned.

Mr. Mara: Gentlemen, if I may read this brief, which is addressed to Mr. Gaston Clermont, Chairman of the House of Commons Committee on Finance, Trade and Economic Affairs.

The purpose of this submission is to express the views of Maple Leaf Gardens Limited on the White Paper on Tax Reform tabled by the Honourable Edgar J. Benson, Minister of Finance, in the House of Commons on November 7, 1969.

I would like to say at the outset that we appreciate and are in sympathy with Mr. Benson's objectives of redistributing the tax burden and achieving tax equity for all Canadians to the highest degree possible.

We do not doubt Mr. Benson's or the government's sincerity of purpose and commend those concerned for taking the White Paper approach rather than fait accompli legislation.

It is the intention in our submission to comment mainly on those aspects of the White Paper which directly affect Maple Leaf Gardens. However, because of the impending critical impact on individuals and the whole social system we are also taking the opportunity of making a few comments of a more general nature.

Maple Leaf Gardens Limited is a public company incorporated under the laws of the Province of Ontario on February 24, 1931. The company own and operates the Toronto Maple Leaf hockey franchise in the National Hockey League, the Tulsa Hockey Club in the Central Hockey League and the Marlboro Hockey Club in the Ontario Hockey Association Junior "A" League.

Besides catering to professional and amateur hockey, the arena accommodates track meets, circuses, operas, ballets, concerts and other cultural attractions.

Our conclusions and recommendations are set out in the following chapters.

1. Effect on Maple Leaf Gardens, Limited

Maple Leaf Gardens, Limited paid approximately $1,700,000 in taxes during its most recent fiscal year. These are summarized as follows:

Federal Income Tax	$ 830,000
Provincial Incore	250,000
Realty Tax	165,000
Business Tax	40,000
Sales Tax on Admission	415,000
	$ 1,700,000

Besides, the $1,700,000 in taxes mentioned above, Maple Leaf Gardens, Limited paid gross salaries of $2,170,000 in 1969, from which $502,000 was deducted in the form of income tax and remitted to the federal Government.

The gross revenue of Maple Leaf Gardens, Limited for its 1969 fiscal year was $6,062,000. Of this amount approximately $4,437,000 represents revenue from gate receipts and concessions. Approximately 55 per cent of our subscribers are corporations, and we estimate that this proportion holds true for most attractions. It has already been indicated to us that many of these subscribers will discontinue if the White Paper proposals re so-called entertainment expenses are implemented.

The following is a statistical summary setting out the potential loss of revenue based on the fiscal year 1969:

Revenue from Gate Receipts, Concessions, etc.	% of Revenue from corporations	Revenue loss
$ 4,437,000	55%	$2,440,000

The following summary compares actual operating results for 1969 with the results that could occur if the White Paper proposals are implemented.

	Actual Results $	Potential Results $
Gross revenue (including interest income)	6,116,000	3,676,000
Operating Expenses (almost 100% fixed)	4,104,000	4,104,000
Operating profit (loss) before income taxes	2,012,000	(428,000)
Provision for income taxes	1,065,000	
	947,000	(428,000)
Extraordinary credit .	76,000	76,000
Net profit (loss) for the year	1,023,000	(352,000)

Senator Connolly (Ottawa West): That $352,000 is an extreme assumption?

Mr. Mara: It is very extreme. It is the worst situation.

Senator Connolly (Ottawa West): Somehow the slack would be taken up.

Senator Croll: We cannot hear you, Senator Connolly.

Senator Connolly (Ottawa West): I say that the slack would be taken up somehow, but perhaps not on a continuing basis.

Mr. Mara: It is a most difficult thing to come to grips with, because we have canvassed a number of corporate subscribers and the one reaction is that they do not think it will happen anyway, so you do not get much satisfaction from that.

Senator Connolly (Ottawa West): We hope they are right.

Mr. Mara: Yes. The other factor involved here is that there have been no seats for sale at Maple Leaf Gardens for 20 years or more on a subscriber basis. I do not know whether one would call this demand an attraction in itself, but if the day came when tickets were somewhat available, my own personal view is that some of the appeal would disappear and there might be a lot more subscribers who would not take up their seats, particularly for less attractive games. If Montréal comes to town we will always fill the house.

Senator Connolly (Ottawa West): Wherever Montreal goes there is a full house. You are too young to answer this question, but in the day of the depression, as I understand it the situation was, particularly in the entertainment world, which includes athletics, that it

was very difficult get continuing subscribers. Do you know if that is the history in the Gardens?

Mr. Mara: It was at the outset, yes. Thank you very much for your comment. I remember being at the opening game at Maple Leaf Gardens. My father had a bad leg and therefore wanted specifically four seats that had been allocated to a ticket agency, Moodey's. These were easily removed from the Moodey's group. Initially it was quite a trick to get continued subscribers during those early years, and Maple Leaf Gardens did not have an easy road early on. It was not, I think, until 1942, or about that time, that the advent of the shortage began for sell-outs.

Senator Croll: You say that since 1942 there have been no new subscribers, generally?

The Chairman: The last 20 years, I think he said.

Mr. Mara: I think it is about that time.

Senator Croll: I am one of the sufferers, and I speak from that point of view. For 20 years I have tried to get a better seat and haven't had any luck. Are there not thousands of people who have made applications, written in and asked to subscribe for tickets on a subscription basis?

Mr. Mara: Yes. There were 9,236 applicants as long ago as 1955, and the list built up more heavily in 1961, 1962 and 1963. There are applications for over 9,000 tickets, which would indicate that perhaps we have no problem. But the validity of these is very questionable. We have a number of addresses returned to us and we really don't know if we send them a bill how effective it would be.

Senator Phillips (Rigaud): Have you not got the further problem that the applications are based upon the present fiscal system of deductibility?

Mr. Mara: Yes, that is correct.

Senator Phillips (Rigaud): Which I think is a crucial point.

Mr. Mara: I am afraid it is.

The Chairman: There is an important point about subscriptions of the nature you are talking about, from business I mean. These subscriptions are pre-paid.

Mr. Mara: Yes.

The Chairman: How would you translate the value of that into the success of your operations?

Mr. Mara: I do not know that I can answer that. How would you translate it, Bob?

Mr. R. E. Giroux, Controller, Maple Leaf Gardens: The subscribers we are talking about pay us by the end of August. In essence, I believe the money takes us through to the end of the hockey season. I would say that the interest earned on that may be $50,000 or $60,000 a year, certainly in most recent years because of the good interest rates.

The Chairman: Because you have the use of the money and therefore do not have to borrow money if you are short of working capital and pay interest on it?

Mr. Giroux: Yes, that is right.

The Chairman: So it is an attractive method of operating.

Senator Connolly (Ottawa West): At the same time, tax has to be paid on it.

The Chairman: Oh yes.

Mr. Mara: In the event that this very bad position might accrue, we set out the federal income tax loss as being $830,000, the provincial income tax loss as $250,000, and the sales tax loss as $244,000.

Apart from the revenue loss to the federal and provincial governments it is obvious that the company itself would be in serious financial difficulty with a very real possibility of ultimate failure. In the event of the above circumstances, either N.H.L. hockey and, to a very large degree, organized amateur hockey as well would disappear from Canada.

The disappearance from the Canadian scene of the Toronto Maple Leafs and the Montreal Canadians, who would be in the same position, is unthinkable. As stated, the effect on hockey in Canada would be disastrous. Hockey is not only Canada's national sport, it is a way of life of countless citizens, young and old, and beyond doubt contributes in a multitude of ways to the building of young men, to the social structure and to the basic fibre of our people.

It is our opinion that Maple Leaf Gardens, Limited and the Canadian Arena Company (Montreal Canadiens) would be better able than most sports enterprises to stay out of bankruptcy in the event of White Paper

implementation. We can only conclude that the sports industry, as a whole, would suffer at least to the same degree and probably even more so.

On balance, it would seem to be questionable whether equity would really be served if hockey, in particular, and the sports industry, in general, were destroyed.

2. Entertainment Expenses

We share the opinion of many businessmen that the term entertainment expenses is a misnomer and that the term business promotion expenses is more appropriate. We firmly support the view that expenses for one's own entertainment, including golf clubs, yachts, etc., should not be allowed as a corporate expense.

(i) Business promotion is a legitimate corporate expense for income tax purposes

We feel that bona fide selling or promotional expenses, including the use of tickets to sporting events, theatres, restaurants, etc., are a legitimate corporate expense and should be treated as such. Such expenses are a very economical use of executive time, whereby an executive can be with his customers, employees, his business associates, for periods other than the short 9:00 a.m. to 5:00 p.m. situation. It is accepted practice that business is promoted in other than normal business hours and in other than normal business environment. The cost of such business promotion is a legitimate corporate expense. The cost of creating goodwill among employees should be included in the same category.

(ii) Present legislation adequate

The present legislation included in the Income Tax Act and the assessing practice carried out by the Income Tax assessors in the field ensure that material abuses of business promotion expenses are detected and taxed. The existing legislation is comparable to that in the United States. We feel it is essential that our tax laws not differ materially from those of our southern neighbours as Canadian industry must compete with them not only for the sales dollar, but also in their search for executives and other personnel. Canadian business must be allowed to compete on much the same terms as its American counterpart. As Americans use pre-tax dollars for business promotion, so should Canadians.

(iii) Revenue to Government

The White Paper states that it is expected to save $5,000,000 in revenue per annum by reason of the disallowance of entertainment and other expenses. We have outlined in Chapter 1 the potential revenue loss to the various governments from Maple Leaf Gardens, Limited alone. The effects on other areas of the entertainment field will be more drastic than the effects on Maple Leaf Gardens, Limited. Most companies in the this field are small operations with fewer employees (many of whom earn the minimum wage and are unemployable in other fields) which could be forced out of business. Many people could be put out of work, which will not only reduce the government's tax revenue from the personal sector, but could cause increased social problems among the unemployed.

We feel the government's view is too narrow and could very easily result in a loss of revenue rather than a gain.

3. Capital Gains Tax

In the interest of income tax equity it may be that a capital gains tax be implemented at this time even though it will inhibit economic growth. Such a tax is in keeping with the taxation philosophies of Great Britain and the United States. In addition, such a tax provides a clear definition of what a capital gain is.

We feel the proposed capital gains tax in some aspects is too radical and punitive. The problems involved in valuing closely held corporations, houses, cottages, art, etc., outweigh the advantage of any increased tax revenues. The taxing of unrealized capital gains in securities of widely held corporations every five years unduly complicates the issue and forces investors to sell securities in order to pay the taxes.

We conclude that a capital gains tax is equitable, but feel it should be restricted to realized gains on land and security transactions.

4. Income Tax

We believe that most Canadians will pay a premium to live in Canada and, in fact, are already going so. However, it is unrealistic to think that up and coming young men in sports, business, or whatever, will not be influenced by the United States market and will be content with too significant a differential in their standard of living. It would be a mistake to give our potential leaders too great an incentive to leave the country.

In conclusion, I would like to say that we are aware of the great difficulty facing all concerned with this critical problem. We most earnestly believe that the White Paper should be modified and hope that our comments will be helpful. Our main concern is that Canada will remain a vital country, full of incentive and opportunity for all and that it does not degenerate into just another colourless, static, socialistic state.

The Chairman: Honourable senators, the meeting is now open for questions.

Senator Hays: Mr. Mara, on your capital gains paragraph on page 6—have Maple Leaf Gardens at any time made any money on capital gains?

Mr. Mara: Yes, we did, on the sale of some securities, the sale of some shares, several years ago. There is another category. There is a category under review at the minute. The one that we are referring to is the capital gains on the sale of securities. The one that is in limbo at the moment is revenue received by way of expansion.

Senator Hays: Out in the future, what would capital gains mean to you in the way of revenue? I am wondering why you are proposing that capital gains is a good tax. You say that you think it is equitable.

Mr. Mara: Perhaps this is a bit of a composite thing. Perhaps it has not been stated very clearly. What we feel is that in the interest of equity, tax equity, possibly capital gains tax at this point is justifiable, even though in our view it will inhibit the economic growth of the country. But if it is necessary to do this, for this mythical holy grail equity, then we feel that the proposed capital gains tax is too punitive.

Senator Laird: What would you suggest taxing in place of the proposal?

Mr. Mara: I am not an expert at all, I am good at being critical and perhaps not very good at being analytical. I would suggest something more in line with the United States practice.

The Chairman: I notice that in your financial statement of August 21, 1969 you show an extraordinary credit in your income gain on the sale of property.

Mr. Mara: That was the real estate at the corner, the parking lot property. That was a capital gain, too.

The Chairman: And you treated that as capital gains.

Mr. Mara: Yes.

Senator Hayes: When the White Paper finally becomes legislation will the Maple Leaf Gardens be for sale?

Mr. Mara: That is a good question, senator. I really do not know. It is a rather confused issue. I should hope not.

Senator Flynn: The problem is to decide whether he should sell now before the White Paper comes into effect.

Mr. Mara: Speaking personally, we did just that yesterday, by selling a brewery. I can say quite frankly the reason I did it was the fear of the implementation of the White Paper.

Senator Everett: Could you repeat that answer, Mr. Mara.

Mr. Mara: I am sorry, I am deaf on one side and I cannot find direction.

Senator Everett: Could I ask you to repeat that answer.

Mr. Mara: The question was about whether we should sell the Maple Leaf Gardens before the implementation of the White Paper. My answer was that personally I would agree with this because we sold a brewery yesterday. I am a partner of this enterprise. It was sold specifically to avoid the consequences of the implementation of the White Paper.

Senator Laird: Whom did you sell it to, Canadians or outsiders?

Mr. Mara: To Benson and Hedges, who are controlled by Phillip Morris.

Senator Laird: That is British?

Mr. Mara: American.

Senator Everett: You might do the same thing with Maple Leaf Gardens?

Mr. Mara: I am not a large shareholder. It is just unthinkable to me to sell Maple Leaf Gardens to American interests or any interests other than Canadian, but from the point of view of the White Paper I am agreeing. Yes, now is the time to get out before the problem arises.

Senator Molson: Has there been any changes recently in the controlling shares of

the Gardens? You said that you are not a large shareholder, but has there been any change in the main blocks?

Mr. Mara: It is just the same.

Senator Desruisseaux: How many shareholders do you have?

Mr. Mara: We have roughly 1500, but basically three major shareholders.

Senator Beaubien: The average hockey player earns quite a good salary. How does the income tax compare on the average good Canadian hockey player to the American hockey player? Do you have any problems there because they are not taxed as heavily in the States?

Mr. Mara: Canadian hockey players who are playing for American teams?

Senator Beaubien: A lot of them would be residents in the States.

Mr. Mara: I am not sure about that. I think that probably Mr. Pollock, who is with us today would be able to answer that better than I could. I do not know the comparison specifically between hockey players and I do not know whether many of them are residents.

Senator Beaubien: They might pay taxes in Canada.

Mr. Mara: Yes, but I do not know the answer.

Senator Everett: Mr. Mara, in my opinion you have raised a most interesting issue. I hope the Chairman will give me permission to question you on it. You say that you sold, in partnership with others, a controlling interest in a brewery because you were concerned about the implementation of the recommendations in the White Paper. I wonder if you would care to be a little more specific wih the committee.

The Chairman: You mean as to what were the implementations that urged him to sell?

Senator Everett: That is right.

Mr. Mara: The implementations to us were that any capital gains tax would be forthcoming and that it would be 50 per cent and that further to this there would be a gross-up every five years of a corporation in which tax would have to be paid, whether there was a capital gains involved or whether there had been any sale or not of the shares.

I would say simply that we envisioned a lot of problems, as well as further ones. Speaking for myself and the people involved in this transaction, we felt that we did not know what to expect from this government.

Senator Carter: Did you sell it to Canadian or American interests?

Mr. Mara: We sold it to a Canadian company called Benson and Hedges, which is controlled by an American company, Phillip Morris.

Senator Carter: I am wondering why they would buy it. They are buying your problems, aren't they?

Mr. Mara: No, not really.

Senator Hollett: It is controlled by the American company.

Senator Leonard: They start from a different base.

Senator Everett: You say there are two reasons, Mr. Mara. One is the five-year revaluation rule which affects your control position and the other was presumably the fact that you felt that the market price of the shares on the day of the sale undervalued the company in terms of what you can sell it for. Would that be correct?

Mr. Mara: Putting it another way, by doing what we have proposed doing, which was building a new brewery in Barrie at an approximate cost of $7 million, paying the high interest rates, et cetera, and going on through a period of five years, we calculated by our forecasts and pro formas the result of this in terms of profits. If we had gone through that blood, sweat and tears exercise we would have arrived at the end of the fifth year at exactly the same position as we are now, provided the White Paper was ultimately implemented. In other words, why go through the blood, sweat and tears.

Senator Molson: Mr. Chairman, Mr. Mara is making me awfully nervous. I wonder if he would recommend whether or not this is good advice for all little breweries in Canada.

The Chairman: Senator Molson, I am afraid that you are going to have to get your own opinions.

Senator Hays: Mr. Mara, you are really against the capital gains tax.

Mr. Mara: I am very much opposed to it.

Senator Hays: In your brief you say:

> We conclude that a capital gains tax is equitable, but feel it should be restricted to realized gains on land and security transactions.

You are opposed to the capital gains tax?

Mr. Mara: Yes.

The Chairman: What he is saying is that if we must have it let's restrict it.

Senator Hays: I cannot understand why all of the business people say let's have it, we are going to live with it and compare it with the United States and Great Britain.

The Chairman: I cannot understand when it comes to the five-year revaluation.

Senator Phillips (Rigaud): Mr. Mara, I should like to put the following question to you: getting away from capital gains and going back to the earlier part of your brief, the White Paper specifically refers to the intent of eliminating entertainment expenses, the cost of attending or sending employees to conventions and the cost of dues for membership in social or recreational clubs. We must assume this proposal is based upon experience, which would seem to indicate that there has been an abuse of these types of expenditures by at least some taxpayers in the country. In the submission of your brief, or in thinking about it, have you entertained the thought that the solution might be a suggestion that the expenses of the type to which I refer, or to which the White Paper refers, should be allowed to the extent either of a specified sum of money per annum or a percentage of profits? In the latter way we would fit in with the principle of deduction, say, for charitable purposes and that sort of thing. Don't you think that might be a better way of dealing with the situation rather than insisting that the present taxes be allowed without any modification by way of legislation?

Mr. Mara: I personally think, senator, that it would be quite fair to have some restriction of that kind—a percentage of profits or some other guidelines within which a corporation would stay.

Senator Phillips (Rigaud): Did you do any thinking prior to arrival here today which would help us by way of a suggestion?

Mr. Mara: No, I am afraid I haven't any suggestion.

Senator Phillips (Rigaud): None at all?

Mr. Mara: No.

Senator Phillips (Rigaud): But you do think there is some merit to the point of view I have just expressed?

Mr. Mara: Yes, I have heard it before and I do think so.

The Chairman: Senator Phillips (Rigaud), it would appear that by having a specific exclusion of this type of expense you would be destroying that worthwhile provision in the present act whereby money laid out for the purpose of earning income is a properly deductible expense. It is a serious question whether that principle should be destroyed, and an exclusion would destroy it.

Senator Phillips (Rigaud): Except that clearly under Section 12, which deals with reasonable allowances and so forth, entertainment expenses, convention expenses and social and recreational and club expenses seem to have caused some trouble. Without interfering with the basic principle of deductions or non-deductions under Sections 11 and 12 of our act, don't see any particular objection to segregating these particular items and dealing with them in the same way as we deal with charitable donations.

The Chairman: In other words, put a limit on it.

Senator Phillips (Rigaud): Either by way of a percentage of profits, an amount, or relate it even to sales, and give it some specific attention by way of recommendation to Government.

Senator Flynn: Of course, the difficulty is that you cannot have the same rule for everybody. For example, selling beer and selling professional services are not the same thing.

Senator Phillips (Rigaud): That may be, but at any rate, I have already stated my position.

Senator Beaubien: Mr. Chairman, has not the department every discretion now, and must it not set a yardstick for all the different industries? If I, for example, started charging thousands of dollars for every kind of recreation, the department would not allow me to do that. They have the discretion now and they must exercise it in every industry to some extent. If they don't, they are not doing their duty.

The Chairman: In the present law the word "reasonable" is used, which means that the department must have some guidelines.

Senator Molson: They are disallowing things all the time.

Senator Beaubien: Yes, and they can disallow anything they want.

The Chairman: The word "reasonable" allows that.

Senator Leonard: Mr. Chairman, it seems to me that in so far as Maple Leaf Gardens is concerned, the total amount involved for expense accounts is a very serious matter, as the brief sets out. But in so far as the individual company that buys tickets for the hockey season is concerned, the amount, it seems to me, would be comparatively small. Surely there is not an abuse that some individual company is spending a lot of money on subscribers' tickets. For example, if a company took a box for the season, how much money would that involve?

Mr. Mara: A box of season tickets, comprising eight tickets, would be approximately $6,000.

Senator Leonard: That would be the maximum involved so far as any company would be claiming an expense account for using Maple Leaf Gardens.

Mr. Mara: That would be pretty maximum, yes.

Senator Connolly (Ottawa West): How many games would that $6,000 cover?

The Chairman: It would be for the season.

Mr. Mara: Forty-one games, including exhibitions.

Senator Phillips (Rigaud): That is almost equivalent to two-third's of a senator's salary.

Senator Leonard: Obviously they are not subscribers.

Senator Connolly (Ottawa West): Mr. Chairman, it seems to me that fiscal policy has a bearing upon sociables. What we find here is a very profitable operation, Mr. Mara. It is a very strong operation. Now, I don't think it is bad because it is big and successful. I think it is good. And I wonder whether you would not agree that the Canadian people, if they were to see this brief, the public at large who are particularly interested in hockey let us say, would not say that it is a good thing to have an institution like this to preserve a thing that they want, which, if you come down to the basic definition, is one of the cultural activities of the people. If these institutions are not kept strong, then they are going to lose the position that the Canadians now hold in the hockey world.

Mr. Mara: I feel this very strongly. I feel that, actually, the Toronto hockey team, which is what we are talking about, and the Montreal hockey team, in a very real sense belong to the people. It is true that they are strong because there have been people involved who have made it so and have invested their money and so on, but, yes, I could not agree more with this point. I think it is obviously in the interests of the Canadian public. They are terribly interested and entertained, or whatever other words you want to use, by hockey.

Senator Connolly (Ottawa West): Do you think there would be a howl, if your position were weakened to the point where you had to withdraw the team?

Mr. Mara: I think there would be a tremendous howl.

Senator Flynn: What you are suggesting, Senator Connolly, is that people generally are not too well informed as to the causes of economic growth and the reason why there is sometimes a slow-down. I think they don't appreciate the kind of society in which we are living, and maybe there should be some time devoted to educating the public as to the kind of society we have and how we manage to grow in comparison to, for example, socialist states.

Senator Croll: Mr. Mara, of the 55 per cent, what percentage of the group would have a box, four seats, two seats and so on? How does it break up?

Mr. Mara: I should say most of them would have maybe two to four seats. The majority, we believe, would be two and four seats. There are some that may have a box, but the majority are either two or four.

Senator Hollett: And these would cost about $18 or $20 apiece per game?

Mr. Mara: No, the most expensive seats are $6.50. That is for a red seat. This is per seat per game, and I think they are the lowest rates in the National Hockey League.

The Chairman: And the blues?

Mr. Mara: The blues are $5.50.

The Chairman: So that you are talking somewhere between $11 and $14 per game.

Senator Molson: I think to put that into focus the box price is related to $6.50 or $7 a year. Six thousand dollars a year is a great deal more, and that is where Senator Hollett got his figures.

The Chairman: That is talking of a box that would contain eight seats.

Senator Hollett: That is $6,000 for 328 seats per season.

Senator Everett: Mr. Mara, in light of the facts that you say you sold your interest in the brewery because of the fear of what might happen if the White Paper were implemented, and indeed you say that this might cause the sale of Maple Leaf Gardens.—or at least it is possible—would it be possible for you to prepare a paper giving the reasons for the sale of the brewery as those reasons relate to the implementation of the White Paper?

Mr. Mara: It would be.

Senator Everett: Could you submit it to this committee?

Mr. Mara: Yes.

Senator Everett: Is that an undertaking?

Mr. Mara: Yes.

The Chairman: In other words, what you want is a study of the implications of the White Paper?

Senator Everett: Yes, in so far as it relates to the sale of Formosa.

Senator Leonard: Which, of course, has nothing to do with the Maple Leaf Gardens.

Senator Everett: I think this will be of use to the committee in seeing how the reasons may apply to other businesses.

The Chairman: I think at this stage we might have a short statement from Mr. Gilmour on the question of entertainment expenses which might help to clarify the issue.

Mr. Arthur W. Gilmour, Senior Advisor: Gentlemen, there has been a general thought that somehow or other entertainment expenses, and I think Walter Gordon used to refer to it as "expense account living", is something that is immoral and should properly be stamped out. But any of us who deal with these matters almost every day realize that today in Canada there are very few personal items charged against entertainment.

The White Paper refers to yachts, private aircraft and all these so-called luxuries that are used, but I am not too sure about yachts anymore and I am not too sure that there are too many converted Fairmiles on the west coast. They have probably come apart. There do not appear to be too many on the St. Lawrence either. But let us take a look at these private aircraft and at those who use them. I see Mr. Stikeman grinning happily at me. Almost invariably these aircraft are used by companies where the scheduled airline is not too convenient, and anybody who wants to spend his time bumping around in those is perfectly welcome to do it. But there is a great distinction between the so-called personal items on the one part and the business expense on the other. But the White Paper seems to confuse the two.

There probably are some expenses that are purely personal, but then there are the other expenses that are purely related to business. Quite a few years ago the Royal Trust Company challenged the deduction of memberships in businessmens' clubs which it required its managers and others to belong to. That was settled by Mr. Justice Thorson of the Exchequer Court who held that as long as these related to a business operation, they were perfectly proper, and the tax department today keeps a very close eye on these things to make sure that there is not an overlapping between personal items and business items. Now any time any one of us takes a client to a club for lunch, it is not customary for us to say "I am feeding myself and that is personal and I only charge the other" because it is a rule of honour that if you take yourself to your club, you jolly well should pay for it. But until the judgment came out, there appeared to be no thought on the part of the tax collectors that the business expenses constituted any problem.

Expenses that primarily applied to conventions of medical and other professions has long been restricted to two conventions a year. In addition, after the Chartered Accountants had the delightful idea of holding their conventions on one of the Empresses, the regulations went further and said that convention expenses did not cover the use of ocean liners. But it would appear that this whole problem has emanated from the Carter Report and has been repeated in the White Paper, giving the impression that

there is something sinful or immoral about a business expense. But in the light of what we have heard today from these gentlemen in connection with business expenses, I would suggest that this committee should not approach this subject with the view that this is something we have to submit to because it is something improper and we must inflict some form of penance on ourselves because of that. The item itself is just as proper a business expense as paying rent or anything else in our modern society.

Senator Croll: Are they not being particularly specific in saying that a membership of social and recreational clubs constitutes their real aim?

Mr. Gilmour: That wording of social and business clubs is probably my own. What are you reading from?

Senator Croll: I am reading from your document.

Mr. Gilmour: Yes, from the White Paper proposal.

Senator Croll: Yes.

Mr. Gilmour:

> ...it is proposed that the Income Tax Act specifically deny deduction for entertainment expenses, the costs of attending or sending employees to conventions, and the cost of dues for membership in social or recreational clubs. This provision would not prohibit the expenditure of funds for these purposes, but it would ensure that taxpayers who wish to make such expenditures would do so out of after-tax dollars.

This is really a broadside provision, because there is an awful difference between your entertainment or business promotion expenses and the cost of conventions, of sending employees to trade conventions. We have had this type of prohibition in other countries. As any of us who have occasion to go to the United States know, where you are entertained, if that is the right word, you are taken out to lunch and ordinarily in between maritinis you will talk business, but the rule down there is that your client asks you, "Will you please make a note that we talked business?" Then honour is served and he is able to say that you have talked business, thus qualifying it as an expense.

If we want that type of damned nonsense here it would be very easy to adopt, but it merely does result in a certain amount of evasion because this type of expense will continue, although in a different form, and I would hazard the guess that it would continue to be deductible no matter what the amendment may say.

Other countries have tried it. I believe at one time in the United Kingdom entertainment expenses for overseas visitors were allowed, as distinct from entertaining your fellow countrymen. The result is that when you went near England all the uncles and aunts for miles around were called in to entertain the overseas fellow, and, again, honour was served.

I would suggest our present system is pretty well controlled and pretty sensible.

Senator Molson: Mr. Chairman, to continue with Mr. Gilmour for a moment. Regarding the next paragraph in the White Paper, paragraph 5.10, it seems to me to be twisting the knife a little. Can you explain that paragraph to me—or is it not susceptible to explanation?

Mr. Gilmour: The latter is probably right, Senator Molson. This is really twisting the knife a couple of times; it is like the old saw-edged bayonet, it is making sure there is a pretty satisfactory wound inflicted.

As I understand this proposal, we have this awful proposal of grossing up dividends to give a dividend credit to a shareholder, and this is, of course, the obsolete British system that is being foisted on us. However, if a company wishes to spend money on entertainment, not only is the cost to be disallowed when you are computing your annual 50 per cent tax, but then, because the shareholders have in fact acquesced in the directors' spending this money, the shareholders are to suffer by not giving dividend credit in respect of this money that has been spent. The reasoning, other than twisting the knife, I cannot understand.

The Chairman: There is no basis in logic for it, not even in the White Paper, though it is the kind of treatment they have extended to the public utilities.

Mr. Gilmour: Yes.

Senator Molson: You have to calculate the tax that arose in consequence of not doing something and are saying there will not be a credit for that amount, and deduct from it the tax.

Mr. Gilmour: Yes.

Senator Molson: Is not this getting far out?

The Chairman: That is getting beyond the fence in left field, Senator Molson.

Mr. Gilmour: The only explanation I can think of is that presumably a civil servant is not allowed and does not have to incur entertainment expense, and right through the White Paper there seems to be the thought that if the civil servant cannot do these things, then nobody else should be permitted to. It is the theory—and perhaps I am wrong on that, but I do not think so—all through this paper, and this last twist of the knife is just being vindictive.

Senator Connolly (Ottawa West): On that last statement, I think we should enter just a short caveat. From my own experience I find that a minister cannot incur expense in Ottawa for entertainment, other than what he is allowed in the normal payment, but a deputy minister can so very often a charge is attributed to the deputy rather than to the minister, and the bill is picked up and paid that way, which is wrong, of course, in principle. If anyone should have the decision as to who should incur expense it should be the top man, namely, the minister.

The Chairman: It is nice to know they have found a way of getting the expense paid.

Senator Connolly (Ottawa West): Yes, even if it is the back way.

In view of what Mr. Gilmour has said about conventions, I wonder whether we will have representatives attend here, of, say, the people who are concerned with conventions, namely, the larger hotels and hotel associations and generally those concerned with the tourist industry, because I think this is going to be an important thing. If they have not yet put in a brief or have indicated they are coming, perhaps we should ask them to do so, so that we can get an industry-wide view.

The Chairman: We have, and if you recall the other day, we heard the Royal Architectural Institute who raised all these questions. Today one of the briefs is to be from the Canadian Dental Association, which deals with this aspect of conventions and the exchange of personnel for educational purposes. We have quite a number of others on the list between now and the end of May.

Senator Connolly (Ottawa West): What I am more concerned about though—because I think the educational value to the professional who is out of college or has been away from training for years is one thing that is very important—is the impact on the industry itself, the hotel industry or the resort industry, if a convention is to be held in the summertime or even in the wintertime, and the impact of that on the tourist industry too.

The Chairman: If you will recall the other day when we heard the architects, I suggested one result might be that an international convention in Canada might be attended by only non-residents, and residents would not be able to come because it would not be a deductible expense, and that would be an odd kind of convention.

Senator Flynn: Mr. Chairman, I think what Senator Connolly is referring to is the fact that the hotel people should make representations. I do not know whether they have been presented to the other committee, or whether they will be presented here, but I have seen some very impressive figures as to the effect of the proposals in the White Paper on the restaurant and hotel industry.

Senator Connolly (Ottawa West): It would be a good thing to know what the revenue to the country is from this industry. The hotel industry or asociation could give us this information. We would then know what the possible effect would be. This is a very important field of economic activity for the country. Indeed, it is more than that, because it has cultural aspects to it.

The Chairman: Senator: Senator, this is in hand. It is being looked after. Are there any other question of Mr. Mara? Apparently there are not. Thank you very much, Mr. Mara.

The next brief for our consideration is that of the Canadian Arena Company. Mr. J. D. Molson, the President, is here, and also Mr. Stikeman, whom you all know and whom we have already heard in these proceedings. Are you going to lead off, Mr. Stikeman?

Mr. H. H. Stikeman, Q.C., Legal Adviser Canadian Arena Company: Yes, Mr. Chairman.

The Chairman: Then, will you present the panel?

Mr. Stikeman: Yes, Mr. Chairman.

Gentlemen, I feel I am here this morning more in the role of a master of ceremonies than an advocate. I have never known a Molson yet who needed an advocate. I would

like, therefore, to introduce to you the principals in this presentation. On my right is Mr. David Molson, the President of the Canadian Arena Company. Next to him is Mr. Sam Pollock, who is the Vice-President of Le Club de Hockey Canadien Inc. of Montreal, which is a wholly-owned subsidiary of the Canadian Arena Company. At the end is Mr. Howard Hamilton, the Vice-President of the Canadian Arena Company.

We feel that some aspects of the matter have already been covered in the interesting presentation of the Maple Leaf Gardens, and I shall try not to be redundant. In order to save time I think I should start by asking Mr. Molson to make a preliminary statement which he feels he should make.

Mr. J. D. Molson, President, Canadian Arena Company: Mr. Chairman and honourable senators, as Mr. Mara said, we are not accustomed to following Toronto. However, we will do our best in the circumstances.

I should like to thank you all on behalf of my associates for this opportunity of appearing before you. I know that time is of the essence, so I shall be brief in my remarks.

To digress for a moment, I would like it understood that Senator Hartland Molson has not had since August, 1968, any direct or indirect interest in or association with the Canadian Arena Company, either as a shareholder, officer, or a director.

Hon. Mr. Phillips (Rigaud): Is that the reason why we did not do so well this season?

The Chairman: That was just an extraneous comment.

Mr. Molson: Our brief deals with two technical aspects of the White Paper, and clearly demonstrates their harmful effect on the company, its shareholders, and the economy generally. The National Hockey League is essentially a North American enterprise. Our competitors, with the exception of Toronto, are all owned by U.S. capital, and they enjoy at the present time a number of significant commercial and tax advantages. For example, they pay no amusement tax, they pay lower tax rates both corporate and municipal, and the players are paid in U.S. dollars. The effect of the White Paper will be to put the Montreal and Toronto clubs at a greater disadvantage, and so make it even more difficult for us to compete with the U.S. clubs. It is vital that any tax reform proposals avoid creating an unwarranted competitive distinction between Canadians and Americans, thus putting Canadian business at a greater competitive disadvantage than now exists.

Gentlemen, it is obvious that the reform proposals are going to create an economic climate very different from that which now exists. The overall effect would seem to discourage individual initiative, private investment, and pride of ownership—conditions which are contrary to our Canadian way of life and the free enterprise system as we know it.

I believe there must be a place in our economic society for private capital. I think that my own family's history is a case in point. The first members came to Canada nearly 200 years ago, and established a tradition of growth and development from which capital has been generated to found and promote new business. Members of this generation aspire to continue this tradition.

I am deeply concerned with the basic approach of the White Paper. I am convinced that its effects will be detrimental to the future of Canada and the Canadian people. I suggest your committee strongly advise the Government to re-examine and re-draft its policies for a more meaningful and democratic tax reform.

Before asking for questions, gentlemen, I believe Mr. Stikeman would like to add a few words.

Mr. Stikeman: Yes. We feel that after that general statement by Mr. Molson we should make it clear that we have two particular objections to certain portions of the White Paper. There are two specific areas which the Canadian Arena Company finds extremely offensive. The members of the committee are able to guess what they are. I am referring to the denial of all entertainment expenses in paragraph 5.9, and the quinquennial revaluation of shares of widely-held corporations.

We do not intend to get into these with any pretence that we are not a special pleading, but we feel that a special pleading point ups the problem which this committee has already commented upon this morning, namely, the effects of the tourist industry and the whole hotel industry, the effects upon other public recreation industries and business in general, which go far beyond, in their implications, the effect on our relatively small but in-pointed company.

We have, therefore, in order to save the time of the committee, limited ourselves as

briefly as possible to an exposé of what we believe these provisions, if driven to the hilt, will do to this particular operation.

We note that invitation extended by the Minister of Finance that has appeared in the press of Canada recently to come forward and indicate some means of regulating the expenses which he seeks to deny holus-bolus. I think our position is quite simple. As Mr. Gilmour mentioned earlier, the *Royal Trust Company* case which was decided as long ago as 1957 clearly states, that even expenses of paying annual dues and initiation fees to social clubs for officers of a most conservative and well thought of trust company were perfectly proper deductions, even though those officers might obtain some collateral social enjoyment from them. It was stated that membership in such clubs was a necesary concomitant of the trust company's business.

The president of the Exchequer Court said in that judgment that you measure all such expenses by the simple standard: Are they within the ambit of the particular business, and proper for it to deduct, and are they, if proper, laid out for the purpose of earning income. We submit that nothing has changed, either in terms of magnitude or in terms of quality, which would lead the Government to make a universal prohibition of the kind that we find so offensive.

The Chairman: Then there is the overriding consideration, namely: Are they reasonable?

Mr. Stikeman: That is right, and that goes through the whole act.

I might add that the lawyer who appeared with me in the argument on behalf of the Royal Trust Company was our present Minister of Justice. I do not believe he has changed his views which he espoused so warmly on that occasion. We will skip through our brief, as I am sure you have all read it carefully.

The Chairman: Yes, you may assume that.

Mr. Stikeman: The figures on page 4 are significant. We find the estimated network of the assets owned total $30 million, of which $15 million, interestingly enough, is paid for what used to be a nothing, but which the White Paper may now permit us to write off, the franchise. In the event the prohibition against entertainment expenses and hockey tickets comes into force it may well become a nothing.

The Chairman: You mean there would be nothing to write off?

Mr. Stikeman: There is nothing there except the franchise and it produces no revenue if we cannot sell tickets. If we look at the $30 million as a base and go down to the next paragraph, we feel that under normal business practice the return that could be anticipated would be $2,500,000 per year before tax, or 8 per cent. Then we show the actual returns for 1969 as being far below that even before the introduction of these provisions and their effect upon us. We see in 1969 a net per cent return before income tax of 6.8 and only 3.13 per cent after income tax. This reduces in 1970, as Senator Phillips (Rigaud) implied, by virtue of the absence of Senator Molson, to 2.65 per cent.

The Chairman: Do you mean the difference puts a value on the loss of Senator Molson's service?

Mr. Stikeman: We should not say that out loud. We then project this forward on page 5 and assume a 10 per cent to 25 per cent decrease in the National Hockey League ticket sales, bringing the profits down on a 25 per cent basis to 1.323 per cent. We should point out that this decrease in earnings has some immediate relevancy, because in the next two paragraphs we indicate that we are among the rare few in this business who have been able, through curtailing dividends and saving our money, to spend $9,800,000 without any Government assistance at all in rebuilding the Montreal forum. We think that is quite an achievement in view of the role which the forum plays in the life of our city and in view of the home which it has provided for the various teams which have played a big role in the life of the country.

I should read the statement at the bottom of page 5:

> This rebuilding project marked the first time since the construction of Maple Leaf Gardens in 1931 that funds from other than Government sources have been invested in a centre for major athletic and entertainment events in Canada.
>
> In other cases of comparable construction, such as in Winnipeg, Ottawa, Vancouver and Quebec City, the necessary capital for construction was supplied, directly or indirectly, by various levels of Government.

We follow that with our statement of taxes paid, which indicates that in our case the

money was going the other way; they did not give it to us, we gave it to them. During the fiscal year 1969 we gave them a total of $2,289,963 on top of being able to spend the moneys which we indicated previously in the rebuilding of the forum. So we feel that we have no reason to feel humble in this particular combat with the White Paper.

In addition, the next paragraph indicates that taxes withheld and remitted to the federal and provincial taxation authorities by the Canadian Arena Company and its wholly-owned subsidiaries on account of their employees, including hockey players, amounted to a federal tax of $324,782.73 more than the $2,289,963 figure, and a provincial tax of $288,641.72.

Senator Connolly (Ottawa West): I hope the press will take note of that, because it is an important factor.

Mr. Stikeman: Yes, Senator Connolly; we have paid our way. The effect upon our reduced number of ticket sales in regard to quality and quantity will, of course, not only impinge upon us, but upon the Government's stake in our own future and the Government's contributions to it at all levels. We feel that if the White Paper proposals are implemented in any other fashion than the law is now being administered on a reasonable basis, as we say at the top of page 7:

> The net profit of the company will decrease sharply reducing the rate of return on the investment below an acceptable level.

Those words "acceptable level" are chosen with some care.

> There will be a net loss in direct tax revenue to all taxing jurisdictions; and the Montreal Canadian hockey franchise will become vulnerable to acquisition by United States interests.

Senator Connolly (Ottawa West): Would you expand on that third point?

Mr. Stikeman: Yes, I think this is my time to ask Mr. Molson to do so. He feels very strongly about it.

Mr. Molson: Yes, Senator Connolly. Going back to the use of the words "...rate of return on the investment below an acceptable level...", a lot of us are going to have to ask ourselves the question when that happens. In that case when we are sitting there with a franchise which is worth so many dollars as a franchise, and then it becomes worthless in Montreal because we are no longer able to operate there because the operation is no longer viable, I have to look to my American cousins, who make up ten-twelfths of the league and say "What other cities in North America do you think would like to have the Montreal franchise?" This would not be a difficult thing to move. Of course, this would be a most distasteful thing to have to do, but inevitably if these things come into effect, this is what we will have to do.

Senator Hays: Mr. Stikeman indicated that it would be unfair competition in hockey, the United States would have the benefit. Would it be possible for this committee to have those views documented? I am referring to the Chicago Black Hawks or the New York Rangers. What is their tax position in the United States in relation to Canada's under the White Paper?

Mr. Sitkeman: I think that was brought out in the preceding brief, although it is a very important question. Their position is more competitive via-a-vis their individual taxation and, of course, more competitive vis-a-vis the taxation of their employer clubs than ours is. In the event it should become unprofitable for a Canadian group to maintain a franchise in Canada and to expose itself and its players to Canadian taxes—you have probably all seen the comparison which Price Waterhouse has made between the individual burdens here and the individual burdens at comparable levels in the United States—then it would become very competitive. If an American group picked up the franchise and based their players below the border and sent them up here for their 183 days, or less as the treaty provides, and also exposed their money to American rates, we would have an accumulative competitive fiscal total of considerable proportions.

Senator Phillips (Rigaud): I would like to pick up Senator Hay's point, because I think we are now more or less consolidating the two briefs that we have before us. I am very interested in what Mr. Molson says on the issue that the two Canadian companies would be in a very adverse position compared with the American companies. I think we confuse the issue by referring to individual hockey players and so on. Perhaps we could have a meaningful chart dealing with a corporate set-up of the American companies, as distinguished from the players, because we are dealing with taxation against corporations, we

are not interested at the moment with the taxation of individual hockey players. Could we get some meaningful material showing that the implementation of the White Paper would put these two very important Canadian companies in a very adverse position compared to the American companies who own hockey franchises?

Mr. Molson: In certain cases this would be possible. However, in an operation like Madison Square Gardens in New York, which is a multi-million dollar enterprise, hockey accounts for only about 16 per cent of the income.

Senator Phillips (Rigaud): I see the point.

Mr. Molson: It is apples and oranges; you really cannot make the comparison.

The Chairman: What about Chicago?

Senator Phillips (Rigaud): I do not want to be cross-examining, because I think this is a vital point for the consideration of this committee. There must be some justification, knowing you as we do, when you make the statement that the implementation of the White Paper would put two Canadian companies—because I am sure you refer to the Toronto company as well...

Mr. Molson: Yest, that is right.

Senator Phillips (Rigaud): ...in an adverse competitive corporation position. Speaking for myself, I am inviting the submission in due course of a working document on that score, because I think it would be very helpful to us in considering what recommendation we have to make in relation to the representations.

The Chairman: Do you think it would be possible, in order to get at those figures, for you to take the Canadian operation in Montreal lift it up and lay it down in some comparable quarters or forum in the States, and then make a comparison of what the tax position would be?

Mr. H. W. Hamilton, Vice-President and General Manager, Canadian Arena Company: I think that would be possible. There would be a little bit of theory to it. I will just point out two or three areas very quickly. On amusement tax we paid 10 per cent on all operations last year, amounting to $583,000. Many cities in the United States have no amusement tax at all, so there is a 10 per cent saving on the gross revenue to start with. In those U.S. cities which do have such a tax it ranges anywhere from 2 per cent to 5 per cent, which is still a long way from 10 per cent. Municipal taxes are a horse of another colour, because they vary from municipality to municipality. However, many of the operations in the United States are run in municipally owned buildings, and are therefore tax-free institutions, so the tenant pays a minimal rental of 10 or 15 per cent on gate receipts, which is his total tenancy, and everything else goes towards his operating expenses.

Senator Phillips (Rigaud): I think the Chairman's suggestion has considerable merit. If you took your company and put you yourselves doing business in the United States, in terms of your total revenue, your attendance and so on, and then with your very able tax counsel, auditors and so on you could come up with a very interesting pro forma for such an operation.

Mr. Chairman: We could do that.

Senator Connolly (Ottawa West): In both these briefs a great deal of attention has been paid to the revenue from the sale of tickets. I imagine there would be substantial revenue from the sale of television rights accruing to the club. I take it they are included in these figures. Is there any implication that if the ticket sales fell the television revenues might compensate for that in some way?

Mr. Molson: A substantial number of dollars come from television revenue, both to Toronto and Montreal. I think what you are asking is whether this would more than offset any decrease in season ticket sales. The answer to that is, No. While the television revenue is substantial, it might be called a nice piece of ice cream to put on the pie, it is not the guts of the operation; the sale of tickets is what keeps the operation going.

Senator Connolly (Ottawa West): In other words, if you fill the rink you do well, but if you have a half empty rink your operation is not viable?

Mr. Molson: Yes, that is right.

Senator Croll: On page 4 you make reference to a franchise of $15 million. What is the basis for that figure?

Mr. Molson: We are basing that figure strictly on what we feel the franchise might bring on an open market basis. The only way we can draw any comparison is to look at

what has happened in other professional sports in North America. Recently in Montreal the Montreal Expos paid $11 million Canadian funds for a franchise to bring baseball into a territory which had been untried in major league baseball, although they had had minor league baseball years ago. Recently the last N.F.L. football franchise was sold for $16 million; the last N.B.A. basketball franchise sold for $10 million. However, all these cases were exclusive of any physical plant. All the Expos did was buy the franchise, they did not supply the stadium, or forum, or what have you.

In Vancouver, we think the franchise was under-priced at $6 million, because it is coming into an area already developed and sold on hockey; it is our national sport; there is a brand new $15 million building sitting there and the operators are coming in to pay rent. No Canadians came forward to buy the Vancouver franchise. It has gone into American hands, it is owned by American capital. This is another example of where no Canadians came forward to take it because they did not think it would be viable.

Senator Croll: Is there a comparable hockey franchise? For instance, what about Detroit? They own the building. Or Boston.

Mr. Molson: I would say that if the Detroit, Chicago, New York, Boston or Montreal franchises were put on the market, either to operate in their present cities or go to another city in North America, any of them would be conservative at $15 million.

Senator Desruisseaux: What price arises between the tickets in Canada and the United States. Are you at a disadvantage with the American prices being charged on tickets in the United States?

Mr. Molson: Yes. On the ladder I would say that we are half-way up. We have a top price of $7 in the forum whereas in New York there is a top price of $8 to $10 but then in Chicago it is $9 and it varies throughout the league. The big thing of course is the amusement tax which we have. There again you have a situation with cities like New York where people are used to going to the theatre and are used to paying $10 to $12 for a ticket to see a performance. It is not unrealistic to charge $10 or $12.

Senator Desruisseaux: This would put you in a disadvantaged position if you compared it to the Americans.

Mr. Molson: There is no question about it. I think it all relates to our whole economic level between the States and here.

Senator Desruisseaux: I have another question. In your brief on page 7 you talk about the inevitable acquisition by United States interest of the Montreal franchise. In the event this proposal goes through how could the United States interest do what cannot be done by you?

Mr. Molson: I think that is probably misworded there, senator. What we are saying is that Montreal would no longer be a viable city to operate a franchise in, therefore, the franchise would then have to be moved and obviously would have to go to the United States. There is no other city, because no other city in Canada could support it under the proposals of the White Paper.

Senator Everett: Mr. Molson, does the amount of the franchise stand on your books as a matter of public record.

Mr. Molson: The amount that stands on our books is one dollar at the moment.

Senator Everett: Mr. Stikeman, you made a point in your verbal evidence that the value of the franchise would be deductible.

Mr. Stikeman: Amortizable. If the White Paper proposals, dealing with the allowance of what used to be called nothings, that is non-physical items which do not have a definite life or ascertainable cost—if those items are not to be allowed, as it appears from some of the indications of the White Paper, it is quite possible that this franchise which is really termed so loosely could be amortizable. This is not certain, but it is something which we perhaps should throw on the other side of the scale in order to be fair.

Senator Everett: By virtue of being amortizable do you mean deductible from corporation tax?

Mr. Stikeman: Bit by bit over the years, since there is no term on it.

Senator Everett: In the case of the Montreal situation, can you tell me should that be the value of $15 million?

Mr. Stikeman: Depending on what the regulations are.

Senator Everett: In your judgment.

Mr. Stikeman: If I may, I would like to use an example of the oil industry. We have a depletion allowance which is a percentage of the profits derived from lifting of the oil from a well without regard to cost. If you look at machinery we have the cost divided over the life of the machinery. Heretofore, franchises to the extent that they are real franchises, that is with a limited term and a fixed cost and diminishing value, are allowed to be depreciated over their term by dividing their cost into their term. I can only surmise that if the White Paper deals with nothings it will attribute some value, but not fair market value, which is replacement cost to a franchise. It would be way down the scale.

This is of little value in our argument, but I merely raise it to be sure that we are fair in looking at all sides of this.

The Chairman: You have not said anything about the capital gains tax.

Mr. Stikeman: We are against it.

The Chairman: You have made one friend right away in Senator Hays.

Mr. Stikeman: I can see that. We face the problem which has been *ad nauseum* I am sure to this committee and the world at large. With the 57 per cent interest owned by the three Molson brothers and on the basis of the figures we developed on pages 8, 9 and 10, it will take one year in the five-year revaluation cycle to deprive them of their control, because it will require them to sell over more than 7 per cent in order to raise the money to pay the tax on a very conservative forward valuation of the shares.

It it would not take too much of your time we might go through a portion of this brief, which I know you have heard before. It does show very compellingly what could happen in a very short period of time.

Senator Phillips (Rigaud): Would you be comforted by the fact if you were told by the Deputy Minister of Finance that the banking system could prvide the money by way of loan, that is with a substantial rate of interest?

Mr. Stikeman: That overlooks the facts of life. We are also not comforted by his alternative proposal in his special supplementary paper which came out at the end of March. He said that if I give up my five-year's revaluation I am going to have to tax the total on realized profit at death on top of the estate tax and gift tax. That seems to me to be rather a *non sequitur* because there would not be very much left.

On page 8 of this brief we say in the second paragraph that the three controlling shareholders, as I have mentioned, own 57 per cent of the 1,025,000 issued common shares of the Canadian Arena Company. It continues as follows:

> The balance are owned by individual and corporate investors. The market price of the shares at present is eleven dollars and fifty cents ($11.50) and, during the last six months, has reached a high of eighteen dollars ($18) and a low of ten dollars and fity cents ($10.50).
>
> The proposal contained in the White Paper requires that shareholders of widely-held Canadian corporations take into income a deemed capital gain (or loss) in the year (after implementation) in which the shareholder attains an age divisible by five.
>
> Assuming that the market value of the shares of the Canadian Arena Company increase and that in 1976 the controlling shareholders reach an age divisible by five, each will be required to include in income the difference between the market value of his shares on Valuation Day and the market value as of the end of the month in which he reaches an age divisible by five. Assuming employment and other income sufficient to place the shareholders in the fifty per cent (50%) tax bracket...

This is not hard to reach even under the White Paper.

> . . . the deemed capital gain of each of the three controlling shareholders will be subject to tax at that rate. (It should be noted that the maximum personal marginal rate of approximately fifty per cent (50%) will not be reached until the fifth year of the new system and, as a result, each of the three controlling shareholders will, depending upon when they reach an age divisible by five, be subject to marginal rates up to a possible maximum of 81.92 per cent).
>
> However, assuming optimistically that the maximum marginal rate will be about fifty per cent (50%), then in 1976 the three controlling shareholders will be subject to a tax of at least fifty per cent (50%) of one quarter of the deemed capital gain.

Because it is a widely held corporation.

> If there is a modest increase in the value of the shares (from twelve dollars ($12) to twenty dollars ($20) it would be reasonable to estimate the amount subject to tax at approximately eight million dollars (8,000,000) and the tax at approximately two millions dollars (2,000,000).

Senator Everett: Could I interject here for a moment, because I do not understand. I thought there were a million issued shares.

Mr. Stikeman: $1,025,000.

Senator Everett: It goes from 12 to 20, which would be an $8 million profit.

Mr. Stikeman: Right.

Senator Everett: But only 57 per cent of that would accrue to the controlling shareholders, would it not?

Mr. Stikeman: Right.

Senator Everett: I think your example is still very valid.

Mr. Stikerman: We took the $2 million out of the $8 million amount subject to tax, at the bottom of page 9, approximately $8 million.

Senator Everett: You say the tax is approximately $2 million. You seem to have taken 75 per cent of $8 million, and then 25 per cent of that?

Mr. Stikeman: 57 per cent of $8 million.

Mr. Pollock: $1,070,000 on $4 million.

Mr. Stikeman: $1,070,000 for the three individuals.

Senator Everett: Thank you.

Mr. Stikeman: It is a good point. So they would have to sell a sufficient number of shares to pay the $1,070,000.

The Chairman: And at $20 a share—which they would not realize.

Mr. Stikeman: They would not realize it. It would knock it down. We think that one of the more serious objections, which does not emerge from the figures, which apparently has been experienced in other cases, is that the competition knows that the controlling shareholders are in a small grouping. This is divisible by five. You take advantage of that fact. By starting to accumulate sufficient funds, with the inevitable decline and sell off that occurs, it might accelerate the slowdown.

Other briefs which I have seen presented have a different interest to that in the present system. It is quite apparent that the problem of marketing a sizeable block would be very difficult, and it would keep on depressing prices, to raise the cash. Whatever the figures should be—and I apologize to the committee if these figures are not as accurate as they might have been—they are not mine—nor are they yours.

Mr. Pollock: No.

The Chairman: They do illustrate the point.

Senator Croll: One thing still troubles me about the $15 million. In the unfortunate event of this becoming an estate matter, would you stay with that figure, or how would you defend it?

Mr. Stikeman: We would naturally argue on the circumstances of the particular situation, depending upon who it was that died. Perhaps no one of the present controlling shareholders would have an immediately depressing effect upon manipulation of that franchise. We would do our best. If you are asking me, as an advocate, to talk that price down as low as we can—in view of what Mr. Molson has said, I think it would be extremely difficult. It is a conservative figure that is there now. In view of what other people would do, who just came in, it may putatively be worth less.

Senator Phillips (Rigaud): I think one could do a lot of the legal footwork from that point of view of value.

The Chairman: I think the footwork would be excellent.

Senator Hays: It is not very often we have such a distinguished witness as Mr. Stikeman, Mr. Chairman, and I should like to ask him a question now, because I know that the cost will be much less today than it would be at any other time.

My question relates to capital gains. The only advantage that a Canadian salaried-person had in that group between $15,000 and $20,000 would be capital gains over the difference between what an American receives and a Canadian receives, which would be, say, $1,800 or $2,000 on your income tax. And the evidence that this committee has listened to since starting its hearings would indicate, although it is not documented yet, that there was an advantage that would be had in capital gains which would probably pick up this

slack in so far as the American was concerned where he would be paying from 25 to 41 per cent capital gains tax. I would just like to have your opinion on that.

Mr. Stikeman: I am not quite sure I understand the question.

Senator Hays: I am not as good as Senator Phillips (Rigaud) in phrasing questions. I did not have quite as much book-learning and so it takes me a little longer to get my point across. But in Canada, as compared to the United States, if you are earning $20,000, in Canada you would pay perhaps $1,800 or $2,000 more on that amount of salary. Now, the American earning $20,000, who probably has a block of stock in the company in which he works, also has a capital gain on his residence which he owns over the years, and this picks up this $1,800 or $2,000, or whatever the difference is. According to all the briefs we have had, people seem to want to live with the capital gains tax, and it seems to me that there is an off-setting factor. Now we take this away and we still have a discrepancy.

Mr. Stikeman: In other words, you feel we should measure a Canadian individual against an American individual by taking into the American individual's total tax picture his capital gains, when he realizes them, that he would have to pay a tax on.

Senator Hays: Yes.

Mr. Stikeman: I am not sure whether the schedules have done that. I don't think they have. In the normal course, a person sells a house and reinvests in another house and he does not often sell too much controlling stock in his own company. With respect to the shares which he buys and sells on the exchange which are subject to capital gains tax, if he is sophisticated, and most of them have become sophisticated in the United States, they wash out with lost sales. I think it would be a worthwhile conparison to make and I think it is a valid point that when we conpare the two now we should compare the two with all tax burdens and not just with the income tax burden.

Senator Hays: If he invested surplus money in mutuals, he would have earned 8 or 9 per cent over the years of surplus money. But now it seems to me we are taking this away and it is one of the points we missed in capital gains, because the group receiving capital gains is the group between $15,000 and $25,000, by way of small real property holdings as well as common stocks, because they have been investing in common stocks.

Mr. Stikeman: Part of that is inflation, the gradual creeping up of values.

Senator Hays: Is it possible, or is it too complicated, to take certain individuals and have a study done on them?

Mr. Stikeman: I believe tables are available that would do what you want. If they are, I will send them to you. If not, I will see what I can do to have them complied.

Senator Connolly (Ottawa West): Mr. Chairman, we don't often have a witness as expert a tax man as Mr. Stikeman. Perhaps we can take advantage of his special expertise this morning.

The Chairman: Within limits. On matters related to the White Paper.

Senator Connolly (Ottawa West): I did not intend to put myself out of order at the outset. I often do, but not this time.

Mr. Stikeman, there are, of course, new implications for the Minister of Finance and the Government in connection with the capital gains proposals. But would you in your experience favour a separate capital gains tax as the Americans have rather than taxing the capital gains at the top of the income?

Mr. Stikeman: I don't favour capital gains tax at all. But assuming for the purposes of our discussion that we both feel it may be inevitable and therefore have to address ourselves to it, I would favour a tax which was closer to the American model and one which was dependent upon less changeable variations than the widely-held-closely-held concept and the unrealized concept, by putting a time limit on it. My answer to you, I guess, is in the affirmative, that I would like to see a time period of holding, below which, if you like, you got a different rate or complete freedom, and above which you were taxed, if you must be taxed, on the capital gains. But I think the tax should be separate from the income tax.

Senator Connolly (Ottawa West): You say it should be separate.

Mr. Stikeman: It should be separate, yes. I don't think you can commit any government, or expect any body of human beings who need more money, to keep the income tax

rate at that 50 per cent ceiling. And if you involve the capital gains tax as part of the income tax, I dont' think you will ever extricate it again, and it will be inevitable that the rate will go up on all gains.

Senator Connolly (Ottawa West): Relating that now to the position of the Canadian Arena Company, would you say that it would help them appreciably?

Mr. Stikeman: Yes. Our objection is being taxed on something we have not realized. It is primarily that. We have kept quiet as to whether we would object to the capital gains taxes as such.

Senator Connolly (Ottawa West): That is another question.

Mr. Stikeman: That is another question, yes. We say nobody should be taxed on something he has not got in his hand, especially when he has to sell off what he has in order to pay for it.

The Chairman: Especially when he has to sell the matter that he holds, which gives rise to the problem.

Mr. Stikeman: Right. The answer to you is that it would be very beneficial to our clients.

Senator Burchill: Mr. Chairman, during the hearings we have had many references to the American capital gains tax. Has Mr. Gilmour prepared for the committee a statement as to what the American capital gains tax is and what the objections to it are?

The Chairman: He is working on that now.

Senator Burchill: I think it would be very informative.

The Chairman: He is preparing a study on the United States and on the United Kingdom which should be available reasonably soon.

Senator Carter: Mr. Stikeman, on page 5 you assume that there will be a decrease in sales from 10 to 25 per cent, due, I presume, to the impact of the White Paper proposals. Is that right?

Mr. Stikeman: Yes, senator.

Senator Carter: In this kind of entertainment, is there very much variation in the kind of sales under the credit system? Does it vary much from year to year?

Mr. Stikeman: I don't think so.

Mr. Molson: Are you referring to the sales of tickets, sir?

Senator Carter: Yes, the same group of tickets you were referring to on the top of page 5.

Mr. Molson: The only thing that would vary would be the figures, if you increased your ticket prices. As to the number of tickets, since we enlarged the building in 1968 the capacity has not changed in the number of tickets.

Senator Beaubien: They are all sold.

Senator Carter: You are sold out?

Mr. Molson: No, we are not sold out. On the contrary, we have a certain number of tickets available for every game. For some games we are sold out, but for others we are not sold out. However, this is in the cheapest range of seats. In the area which everybody likes to sit in, which is the box seats and the more expensive seats, yes, we are sold out.

Senator Carter: What is your waiting list?

Mr. Molson: Our waiting list? We don't have a waiting list. I do have a file, as I say, 90 per cent from corporations and companies who all want eight box seats, but in terms of the $3 gallery or terrace seats we have a substantial number that are unsold and are available for season ticket-holders. In fact, Mr. Hamilton informs me that we have 1,000 of them.

Senator Leonard: Mr. Chairman, may I ask Mr. Molson if the situation in respect of the Canadian Arena Company is the same as that which Maple Leaf Gargens told us about, that the great majority of subscribers who might be treating these as entertainment expenses are subscribers to the two seats and four seats and that that covers the great bulk of subscribers?

Mr. Molson: As a general statement, I would agree with that.

Senator Croll: Mr. Molson, have you ever had a change in prices in recent years?

Mr. Molson: Yes, we increased our prices last year.

Senator Croll: With no falloff in subscribers?

Mr. Molson: No.

The Chairman: Thank you, gentlemen.

The Chairman: The third brief this morning is from the Executive Council of the Canadian Chamber of Commerce. Mr. Byers is here as Chairman of the Executive Council. He also has a panel with him, and they will answer your questions when we come to the question and answer session. Mr. Byers, I take it you will lead off?

Mr. D. N. Byers, Chairman, Executive Council, Canadian Chamber of Commerce: Very briefly, Mr. Chairman. I will leave most of our submission to the members of the panel because they are the experts.

Mr. Chairman and honourable senators, I am here in my capacity as, in effect, the Managing Director this year of the Canadian Chamber, and I have with me members of the Chamber's special tax committee that has examined the White Paper which was chaired by Mr. Frank Capon, who is next to me, with the assistance of Mr. Lionel Kent, Mr. H. P. Crawford, Mr. Gordon Riehl and Mr. Tropea of Montreal with the assistance of Mr. George Demers of Quebec City who is the second vice-president of the Canadian Chamber.

We are very pleased to have the chance to be before you today. In the preparation of our brief, we appointed first of all a special committee, and drafts of that special committee's brief were sent across Canada to our membership of more than 800 autonomous Boards of Trade and Chambers of Commerce. From a great many we received comments which filtered back to the Special Committee and are reflected now in the brief we have put before you. I think it can be said that our brief represents not only the larger businesses but also represents fairly the businessman large, medium and small from coast to coast in Canada.

One comment I would like to make is that for many years the Chamber has been asking that changes in taxation should be presented by way of a White Paper rather than by way of a draft bill, and we did want to take this occasion of saying that the Government at least in that respect has taken a wise step by presenting it in the form of a White Paper which frees the debate very considerably not only from the point of view of the Senate and Commons committees.

We propose not to read or go through our brief in detail with you because it has been sent up ahead of time, but I would like with your permission to ask Mr. Capon if he would make some general introductory remarks on the brief, and then subject to what you approve, it might be preferable for the members of the committee to ask questions directed to the various experts on our tax committee.

Mr. F. S. Capon, Chairman, Tax Reform Committee, Canadian Chamber of Commerce: Mr. Chairman and honourable senators, I think it is probably very fitting that this brief should have been published in the purple of penitence. Your committee has already received our brief together with a summary of its contents. I think it would be superfluous for me to make still one more summary statement for you. However, I would like to take this opportunity to focus attention on our major concerns and the main reasons why we have taken the position set forth in the brief.

We are all well aware of the speed and extent of change in the world and it is important to recognize that it is changing needs for the future, rather than basic inadequacy of existing law to meet the conditions for which it was designed, which makes tax reform necessary now. Thus, our primary concern has to be—will reform proposals do the best possible job for the future?

Because of the speed and extent of technology breakthroughs, every major decision today calls for a vastly greater commitment of money and other resources than was the case only a few years ago. At the same time new facilities or systems remain valuable for ever-shrinking periods. Thus the economic impact of decisions has increased immeasurably, the economic waste involved in error is now very great, and the cost to total society of incorrect policies is becoming catastrophic, whether these decisions be of business, of government or of other sectors.

In our competitive market society, almost all of the nation's real wealth is produced by its business sector, to be distributed as wages for work done, as payment for materials and services, as donations for education and health, as taxes to meet a large share of government outlays, and so forth. Thus the nation depends upon the business systems for its living standards. In coming before you today, we do so not in selfish concern for our small profit margins, but rather in an attempt to ensure that legislators hear from us how we expect the tax reform proposals to affect our future ability to generate the incomes and employment of Canadians.

The generation of the nation's wealth has always been a function of two factors, human

effort or work, on the one hand, and capital or tools, machines, money and land on the other. The relative importance of these two has been changing gradually for centuries, but in the past few decades the relative importance of capital has increased phenomenally. Thirty years ago, $3,500 of capital was needed to finance each job, and today that figure is over $250,000. In the oil industry it happens to be between $250,000 and $500,00. Net new capital invested by business in 1969 in Canada was $10.2 billions, and just to maintain incomes and employment for Canadians will call for a doubling of this annual figure in five years. But to increase average incomes by achieving an improvement of 4 per cent a year in productivity would mean that $25 billions would have to be invested in new facilities annually by 1975.

We cannot reverse this trend towards growing reliance on capital as the generator of national income because we must keep ourselves competitive with the most modern technological processes if we are to get the lowest possible cost per unit of goods and services. We cannot stop the growth in population and thus in the work force seeking employment, and therefore we must have more output, more plants, more investment. And because this is a problem throughout the world, Canada must compete with other nations as a desirable place for investment either by Canadians or by foreigners.

It is thus imperative that our tax structure be designed to offer whatever incentives are necessary to assure a high and increasing rate of new investment by business in Canada, and that our tax structure will be competitive with those of other countries in its impact on investment and productivity. It is because the White Paper proposals in total would have precisely the opposite effect that we are so concerned. By placing the top priority on redistribution of incomes, rather than on increasing the total national income available for redistribution, the proposals would make new investment in Canada less attractive, would further penalize our most productive people, would add significantly to the cost of goods and services, and would therefore weaken Canada's competitive position in the search for new capital and growth. In the face of our growing requirement for new investment to provide jobs and incomes, we surely need a very different type of tax change at this time. Unless Canada is prepared to assure investors, including Canadian investors, of long range policies favourable to business expansion, how can we expect to satisfy the aspirations of those Canadians who seek higher incomes, steady employment and more rewarding lives?

Inflation has been described by government, by labour and by business as the greatest threat to Canada's long term welfare. Yet the total effect of the White Paper proposals would inevitably increase inflationary pressure in Canada. At the height of Canada's war effort, when we were all deeply concerned over the inflationary impact of such heavy government spending, governments took 28% of our total G.N.P. If the White Paper proposals were adopted in total, Governments would soon be taking 40% of our G.N.P.—here this figure is already about 38 per cent, in the United States, with their war situation and space exploration, it is about 30 per cent, and in Japan 22 per cent—much of this representing transfers from those who save to those who cannot save. Such a situation could only add seriously to inflationary pressures.

The proposal to adopt, if only in part, the Carter Commission recommendation to eliminate the double taxation of income earned through investing in corporations is a constructive step, although there is no justification for the artificial distinction drawn between closely and widely held corporations. A corporation is nothing but a common purpose in which a number of human beings share and to which they contribute their personal services or their capital, expecting some return. You cannot tax a purpose, you can only tax people. And there can be no equity in taxing twice that income which investors earn through their participation in a company, when the income of every other participator is taxed only once. Certainly, there will be transitional problems in correcting this longstanding inequity, but once adopted in full this correction could be a significant factor in aiding Canada's future prosperity.

Mr. Chairman, the various members of the Chamber's Tax Reform Committee here present are ready to provide you with any further explanations you may need concerning our brief or any supplementary remarks, and because each of us is specialized in certain areas we will refer questions to those we feel are best able to answer them.

The Chairman: Now we will revert to questions and answers.

Senator Laird: Could I start off, Mr. Chairman, by drawing to the attention of the witnesses their own summary and the heading "Small Businesses". You have stated, of course, that you represent all business, both big and small, and there you say:

> Small businesses that require capital for expansion purposes should be granted special incentives.

I would like to ask two questions. First of all, are you suggesting that the present state of the law is not satisfactory for small businesses, supposing it was not changed at all?

Mr. G. W. Riehl, Member of Tax Reform Committee, Canadian Chamber of Commerce: In the present state, as far as the small corporations are concerned, the lower rate below $35,000 definitely is of assistance to small corporations.

Senator Laird: Also might I point out to you the absence of any tax on unrealized capital gains which is proposed? Those two things would seriously affect small business if you took them away, would they not?

Mr. Riehl: Yes.

Senator Laird: All right. Now, are you reconciling yourselves to the proposition this could happen and at the same time saying small businesses need tax incentives? If so, then what tax incentives?

Mr. Riehl: There has been mention made perhaps of abuses of the split tax. I think there should be some formula devised which would apply to small corporations which sell goods and services as opposed to a corporation which is an investment corporation, that should be in the form of equity because the availability of equity makes available the possibility to make additional borrowings from the banks. In other words, if you have a $10,000 tax saving, it may mean the ability to borrow another $20,000, so you can complete your working capital, so any incentive should probably be in the form of equity. It should probably be a deferral and not necessarily a once-and-for-all saving. At the present time about two-thirds is deferral and one-third saving. Probably if further equity is to be achieved it should be related to an increase in sales. So, therefore, it would go to corporations that really need the increase in working capital.

I believe the suggestion has been made in the White Paper and the Carter Report that the assistance is needed to acquire capital goods. I doubt whether that is where the real need is. It would be of no use to a wholesale or retail corporation, for example, and at the present time there are other means of getting write-offs of capital items by such means as lease-backs and so on.

Senator Laird: Are there any other incentives you might have in mind for small businesses

Mr. Riehl: I think that would be the main one. I think the Industrial Development Bank serves a good purpose.

The Chairman: Mr. Riehl, on that point, would you regard as a defect in the present treatment of small businesses, as this particular item is designated, the extending of the 21 per cent on $35,000 to every corporation?

Mr. Riehl: Well, when it gets to a large corporation it is not a significant benefit.

The Chairman: The objection or the criticism, and the support for the change, seems to be because it is extended to every corporation.

Mr. Capon: Mr. Chairman, I think this discussion puts into focus one of the big problems we have in submitting a brief for the Chamber. The Government spent several years and millions of dollars in producing the White Paper, which is very exhaustive. The Chamber felt that it had to try to cover the same ground, but it could not take two or three years and spend millions of dollars in producing an alternative total package in the same detail, so we had to settle for some rather general statements on the assumption that when the chips are down we will be able to get back to the legislators, or those drafting the legislation, to work some of these things out in detail.

Now, on the small business proposal, you will find that we have not said, or have carefully avoided saying, that bigger business should receive the lower tax rate on the first X dollars of income. We have said that this is a small business problem, so leave big business out of it.

The Chairman: Let me put this to you, Mr. Capon or Mr. Riehl: If you define a small business as being a business that generates profit or income of not more than $100,000, then at least you have a definition. Then if you said that such companies with that degree of earning would be entitled to 21 per

cent on the first $35,000, you would immediately throw up over $10,000 a year in extra working capital, and then you would treble that perhaps in the credit facility that could rest on that additional amount of retained earnings.

Mr. Capon: That is correct, senator.

The Chairman: Now, it has been suggested by some writers that this is not the best way or the real way of helping small business; that what they really need is—and they can get better help from it—is increased capital cost allowances and the provision for loans, where the credit by some outside source, presumably the Government, would provide the background for the loans they could get.

Would you care to put those different factors in their proper positions, Mr. Riehl?

Mr. Riehl: First of all, dealing with the increased capital cost allowance, this would provide no relief for a corporation that was a wholesale or retail operation. It is an advantage only to those corporations that require machinery or capital goods and which, as I mentioned before, are able to lease that machinery and thus get an immediate write-off. This is not where the real relief is needed. If a small corporation is having problems in expansion it is because it has not got enough working capital. It has to turn away sales. It cannot accumulate enough inventory to look after orders. It cannot afford to give more credit to its customers...

The Chairman: This is what the B.C. Forest Products Association, representing a tremendous group of operators out on the west coast, told us was their problem in the area of small business, namely, that they had to generate capital in their own operation, and therefore they could only expand and put in improvements in their operations on a very gradual basis, and they could not be competitive with the U.S. operations.

Mr. Riehl: I am not denying that there is also a problem in acquiring machinery. I am saying that generally speaking with small business the problem is lack of working capital.

The Chairman: Basically, then, the small business should have the advantage of being able, to the extent possible, to generate capital through retained earnings? Is that right? Would you subscribe to that principle.

Mr. Capon: Well, we subscribe to that principle, Mr. Chairman, to a limited degree, because if you give the support to small business as a loan to be repaid, then while it may be helpful it nevertheless is not a big incentive. Our concern is that in Canada as a whole small business tends to take a larger proportion of that kind of total economic activity than in, for example, the United States. We are still a developing country, and we need that particular kind of entrepreneurship that comes from the small businessman. We feel that it is a plus value in Canada as a whole, and therefore we say that we should provide some kind of incentive to enable that man to prosper. If he prospers and grows then he ceases to require the incentive.

The Chairman: What you are saying is that notwithstanding capital cost allowance, and notwithstanding loans, there is still a need for a tax rate on a basis, once you define small business, that will enable that small business to generate some reasonable amount of working capital?

Mr. Capon: That is what we believe.

Senator Laird: What is wrong with the chairman's suggestion? It is very interesting, I think.

Mr. Capon: There is nothing wrong with it at all. We just did not, in our committee, pin ourselves down so specifically on each item. There were many hundreds of items where we could be specific, but we felt that we had to stick to the generalities.

Senator Phillips (Rigaud): Mr. Capon, I should like to discuss two questions with you. At the bottom of page 11 of your brief, in paragraph 35, you say:

> The Chamber's views on federal-provincial considerations can be put quite briefly. We regard as of overriding importance the necessity that whatever final form it takes, tax reform must carry with it the support of the provinces. We appreciate the Government is aware of this necessity and we wish to make it clear that the Council of the Chamber concurs in this position.

Then I would like you to go with me to page 16 where in the last two lines at the bottom of the page you say:

> We, therefore, regard it as essential that the approximate 50 per cent maximum rate become the cornerstone of Canada's future tax system.

Now, having regard to the importance of the representations that you gentlemen are making, we know that the provinces up to this point are expressing dissent in general terms. We also know that the parliamentary system provides for flexibility in tax structures, depending upon submissions in any given year to Parliament. Can you help us in fashioning an approach that we should make in a study of this White Paper when we are making our study on the basis of two fundamental factors, neither of which are concrete and present, to wit, the absence of consent of the provinces, and the fact that there can be no constitutional or legal assurance that the rate structure will not exceed 50 per cent?

Mr. Capon: Senator Phillips, we are very well aware that there cannot be any constitutional or legal structure which will guarantee that rate, and we are also painfully aware of the extent of difficulty between the levels of government in establishing tax structures that in fact are co-ordinating. Nevertheless, we have to say, as businessmen who are trying to do business across this country, that this is a very difficult piece of economic geography in which to carry on business. In fact, the bulk of the land is about 4,000 miles wide and 100 miles deep, and it sits on top of a much more compact piece of land that has ten times the population and a much easier climate. So we have a very difficult piece of economic geography in which to operate our businesses.

Then, that narrow belt is cut up into a number of units which at this point of time are seeking much broader tax bases and are looking to see who to tax. That generally tends to be businesses; it is easier to tax businesses than people. However, these are all very competitive parts of our competitive cost structure in this country. Unless the country can find a way to co-ordinate its tax structures and keep them competitive with other countries with which we must compete, then we are saying that we, business, are not going to be competitive and we are not going to achieve economic progress, higher incomes and higher employment.

Senator Phillips (Rigaud): What I have asked is by way of a foundation to what I wish to press with you, gentlemen, further. We are approaching a complex problem and we have two factors that are absolutely uncertain. One is the consent of the provinces, and secondly the rate structure. You have complimented the Government on the fact that an opportunity is being given to the country at large to express their views with respect to this White Paper. We all know, however, that particularly outside Canada and to a considerable extent in Canada, the chart has been regarded more or less as a letter of intent on the part of the Government and has created considerable concern in business and industry. That being so, in order to clarify the situation this committee—I am speaking as an individual—may consider the necessity of at least dealing on an interim basis from the point of view of making interim recommendations having regard to the complexities, and so on, to which I have just referred.

My question is, with the experience of your very important organization, to what items should we direct ourselves in your opinion and that of your colleagues with a view to obtaining clarification? By way of example, should we deal with capital gains savings, small business, natural resource industries and the treatment of offshore companies in terms of, I would not like to use the words "an economic crisis", but in terms of the consideration of the whole White Paper? Assume that we were to deal with five items, so as to allay uncertainty, problems of tax saving and foreign capital coming in, all of which I may say were brilliantly dealt with by you and Mr. Byers, and I mean that in all sincerity. Supposing we were to be concerned with five items that concern us in the main, what does business have to say through your organization are the subjects?

Mr. Lionel Kent, Member of Tax Reform Committee, Canadian Chamber of Commerce: Mr. Chairman, honourable senators: by a happy circumstance our brief does concentrate on perhaps half a dozen major matters. It was because of the mass consideration of which our chairman spoke in opening that we felt it was imperative to concentrate on those vital matters which either did so much damage or improved and evolved a tax system which contributed to the business climate of the country, rather than the reverse. So, answering your question specifically, Senator Phillips (Rigaud), we feel that the areas to which we should address ourselves in terms of a progressive tax reform, rather than an attempt at a holus bolus tax reform are these areas which we have pinpointed before you. It is obviously having such a direct effect upon the country, as we heard earlier this morning, that we feel that we should address ourselves to the prospective moves for taxation of capital gains. I may say

at the outset honourable senators, that as an organization we have a long record of being historically opposed to capital gains as being not the best economic prescription for a country in its present circumstances. However, the implications of the White Paper to capital gains are so important that we feel that it should be addressed as a priority. Again I point out that were we to have a form of capital gains we say to you that it should be clearly defined by a time period, a minimum of three years. There should be no capital gains unless realized and there should be no capital gains deemed on death. This is only on the predication that we must have them.

The next area that we feel is of major importance is the whole integration of the corporate and personal income. I might say in relation to my earlier comments on capital gains that it is only because of the potential benefit of the integration of corporate and personal income that the Canadian Chamber of Commerce is even prepared to contemplate a capital gains. However, if as part of the price of that there is introduced into the tax legislation a reconciliation of personal and corporate income, there should be no artificial discrimination between a widely-held corporation and a closely-held corporation. We find it impossible to differentiate the type of earnings that come through one corporate vehicle or through another corporate vehicle. That would be the second major point.

The third major point would be to consider...

Senator Phillips (Rigaud): May I pause for a moment, because this, to me at least, and I am sure to my colleagues, is terrifically important. Suppose we concluded that integration of income is something that we do not like. As I understand it you still do not like the distinction drawn between privately-held and publicly-held corporations?

Mr. Kent: Precisely, sir.

Senator Hays: Mr. Kent, when you say you are opposed to capital gains it seems to me that it is the same as saying thou shalt not commit adultery, but if you are going to, this is the way to do it.

Senator Phillips (Rigaud): We are all open for suggestions.

Senator Hays: You have perfectly good reasons and all of a sudden you change.

Mr. Kent: No, Senator Hays; I think that we are maintaining a completely consistent posture. We say that we are looking at this in total as a package. It is presented to us a package. Therefore, if it is going to take one form, we must consider the form that would emerge. If there is to be no integration between corporate income and personal income, we say we are completely and unequivocably opposed to any form of capital gains tax. If there is to be a lessening of taxation through that route on a form of investment income, it may well be that clearly defined, and under proper rules, capital gains might find a place, only within that context.

Senator Phillips (Rigaud): I am sorry I interrupted you. You were going to item 3, I understand.

Mr. Kent: I was going to item 3, which of course is the consideration of the position of a small business. We very clearly differentiate that from any system of taxation that makes for a lower rate of tax on first dollars earned from corporate income. We say that is a special problem to be considered by itself in terms of both the economic and social place of the small business in the life of the country.

We proceed from there to the integration of estate and gift tax.

Senator Phillips (Rigaud): Before we get to that, still dealing with the small business, taking myself as an example citizen, I veer more towards a low rate for small businesses earning profits up to X, or in terms of small businesses being defined as those that do Y amount of business as against incentives. Do I gather from your brief you go more for incentives rather than my approach?

Mr. Kent: Not necessarily at all. We feel this is an area which must be individually studied and defined.

Senator Phillips (Rigaud): Thank you very much. I think you were on item 4, dealing with estate tax.

Mr. Kent: We were dealing, of course, with the co-relation of the Income Tax Act with the Estate and Gift Tax Act. We then proceed to the necessity of incentives for peculiar industries. Here again, very deliberately we have not attempted to make a case for any particular industry. We feel that they are far better qualified to make their own cases. Nevertheless, we recognize the historic place that incentives have played in the development of our natural resource industries, and

we say those can be adjusted only with due consideration to their total effect.

Senator Phillips (Rigaud): I am very grateful to you. I think that is very helpful.

Mr. Kent: We are, of course, concerned about an even further worsening of the taxation position of a utility company. There we draw the attention of honourable senators to the inequities that would be compounded were the tax treatment of dividends of a utility company to receive completely different tax treatment from anything else.

We then have other lesser points, and it may be of some note to honourable senators that I have not included as one of the major points the whole question of so-called entertainment allowances, or prohibition by fiat of certain kinds of business expenses, because we feel this is nothing more nor less than a red herring. We believe there is a very adequate law at the present time that brings these expenditures under scrutiny, and that in terms of tax reform this item really finds no place whatever. The rest of the brief speaks for itself.

The Chairman: Mr. Kent, I notice you talk about Canada's competitive position, and refer to the heavily increasing taxes on the middle income bracket. I would like to ask you a few questions on that. We have learned in the course of our hearings that to take 750,000 people off the tax rolls involves a loss of tax revenue of about $35 million a year. We then discover in the studies we have made that by this process of increasing exemptions so as to accomplish that, when getting up to an income of maybe $6,000 for a single person and perhaps $8,000 or $9,000 for a man with married status, the increased exemption is taxed back as part of the increase in rate.

With that background I want to suggest this to you. Suppose in relation to the 750,000 people who admittedly you want to take off the tax rolls you dealt with it on a dollar basis of a single man's revenue dollarwise above which he would be taxable and below which he would not be taxable, and the man with married status on the same basis. It appears to me that there would be a cost of $35 million. However, in those circumstances, if the exemptions were left above that—in other words there were no exemptions to that point—at their present rate, there would be no need to increase the income tax rates. There is this tremendous loss of revenue by the billion dollars, where increased exemptions are given, and then the rates are increased as part of the program of getting that money back.

Mr. Kent: I can do nothing but agree with you, Mr. Chairman. I take it what is implicit in your proposition is that there will be not only a graduated rate of tax but a graduated rate of exemption.

The Chairman: Yes.

Mr. Kent: I do not think we have considered the full implications of that in our committee, but I may say that we are much concerned about the whole effect of this transference of tax burden and the centering of that burden on that middle income band of the most productive people in the country.

The Chairman: That is the middle income bracket from which comes the greatest percentage of savings.

Mr. Kent: That is right.

The Chairman: We have been told that when the White Paper is fully implemented the effect will be to increase tax revenues by some $650 million. That means at the expense of savings.

Mr. Kent: That is right.

The Chairman: You know as well as I do if you went into a bank with $650 million in savings the amount of credit that could generate and the benefit to business that would be.

Mr. Capon: This is right, Mr. Chairman. This is why we put so much emphasis on that point in our brief. This is one of the main points we wanted to make. It seemed to me from the question Senator Phillips posed to Mr. Kent that may be I could add a few words that might be significant if there was any question of making interim proposals. My fear would be that whatever proposals we make should be aimed at a principal objective or set of objectives rather than picked out of the air. In my opinion we should first decide on what objectives we are trying to accomplish. We have said in this brief that the nation's objectives are to increase the total amount of wealth generated, increase our prosperity and increase the incomes of Canadians as well as provide better employment.

If we were to pick five items I would first say that there should be a shiftin emphasis

from the redistribution of wealth to the emphasis on growth so that any charge I made would have to be consistent with the first objectives. My second objective is that we must be competitive in this country in our cost structures and tax structures, et cetera.

Senator Phillips (Rigaud): May I take a few minutes on this one. You say shift of production rather than redistribution.

Mr. Capon: Yes, generate more wealth as a first priority even though that means that you have to place in a second priority the equitable redistribution.

Secondly, I would say competiveness which has to do both with the way we tax the business system and the individual person. Here again, our big concern is that the total effect of the White Paper, including its rate changes, puts so heavy a burden on the most productive band of our people that the nation ceases to be competitive.

Thirdly, I would say that in any tax reform we should avoid talking about tax rates which are designed to increase the total tax burden. That has to come when we are trying to pass legislation which increases the cost. If we were going to have some new legislation which calls for more government burden that is the time to change the tax rates, but not mess about with them as an excuse for tax reform.

My fourth point would be the importance of giving incentives to those parts of the country and sectors or those kinds of businesses, if you like, which are going to contribute most to our growth and revenue. That may be the resource industries and we leave them to argue their case. Our point is that we must put emphasis on getting those incentives in.

My fifth point would be the importance of federal and provincial coordination of taxation so that the two do not combine to stifle the country. I would attack it from rather a different point of view than taking five individual items out of the tax law and saying let's change those five. I would feel that anything you pick out of the tax law to change should be consistent with the broad objectives.

Senator Phillips (Rigaud): I accept what you have said which is of course very important. It is not inconsistent (a) with the questions I put and (b) to the answers as to the holdings except those holdings under which our recommendations do relate themselves to the objectives to which you have just referred.

Mr. Capon: That is right.

Senator Phillips (Rigaud): Mr. Kent, I am rather surprised in the priorities that no reference has been made to the problems of offshore companies.

Mr. Kent: They are of course very peculiar problems and they react in two ways. They react in terms of the corporations and their existence themselves and also on the whole question of the amount of foreign investments that we will attract and hold in Canada. Through our treatment of these special corporations and the non-resident owned corporations we will display to the world how we are going to receive foreign capital investments. Perhaps I was looking at your question rather literally. I would put that low on my list of priorities for present and pressing change.

Senator Phillips (Rigaud): Thank you.

Senator Everett: In item 37 under the heading of Capital Gains and Integration you state:

> Full integration should be permitted for dividends from all Canadian companies received by Canadian residents.

To make the point in both the pragmatic and philosophical section of the brief that integration should be available to all types of companies. I wonder if we could deal for the moment with the position of a public company as defined by the White Paper as a widely held company. How would integration work.

Mr. Capon: Simply on the basis that the income earned by the company is always the property of the shareholder. It legally may be the property of the company, but the company is the property of the shareholder. We simply state that the income earned by a company is income earned by the shareholder through that particular route and any tax levied on that income is therefore a tax levied on the income of the shareholder through the investment routes. It is no different from income he may earn on bond interest, but any tax paid should therefore be offset against any final tax found payable when that income is transferred to him.

Senator Everett: Would you use the grossing up system which is recommended in the White Paper and the creditable tax as an offset?

Mr. Capon: Senator Everett, I would hope that in the long run we Canadians would be intelligent enough to recognize that if this kind of income is personal income and that the corporation tax is only a deduction at the source then we would, in fact, be able to eliminate the corporation tax structure as a whole and recognize that the personal tax is what applies.

Our corporation tax structure is an incredibly expensive mechanism. All of our big corporations spend millions of dollars a year just trying to keep track of these things and it is a great drain on the country. In the meantime we have a transition period to overcome. We live with the corporation tax structure while we overcome it.

I would hope that in due course we would be able to avoid that kind of completely non-productive cost which adds to the Canadian cost structure and which reduces our standard of living without affecting government revenue in any way.

Senator Everett: You are saying that corporation income should be credited directly to the shareholder and that the shareholder would be subject to liability to tax to a maximum of 50 per cent. This is in accordance with your brief.

Mr. Capon: We are saying that so long as the income resides in the corporation it is taxed at a rate which is in fact a withholding tax against the income which the shareholder receives when he receives the dividends. That withholding would prevent the corporation from just holding on to income so that he would not be taxed, but always recognize that the income is always the income of the shareholder.

The Chairman: Would you permit me to inject one question?

Senator Everett: Yes.

The Chairman: In that relationship what comment would you make on the proposal in the White Paper on the 2½ year limitation or the shelf provision, as we have been calling it, on our accumulation of earnings of the corporation. You can't get the benefit of the integration unless you pay it out within 2½ years.

Mr. Capon: This is right, senator. Any kind of withholding tax, once the corporation income is recognized as a personal income, would tend to be a pressure on our corporations to pay out the earnings. This is something we would have to recognize.

Senator Everett: It seems to me that all the public companies that have come before the committee have suggested that this would seriously affect their ability to finance new projects; that, if the corporation tax were nothing more than a prepayment of what is rightfully the income of the shareholders, there could be almost no self-financing.

Mr. Capon: Senator, you have me in a very difficult position because I submittted a personal brief to the Carter Commission explaining that particular point at length. But I have not tried to get the Executive Council of the Canadian Chamber of Commerce to support that particular position. I should like to have Mr. Kent speak on that point.

Senator Phillips (Rigaud): Know you as I do, Mr. Capon, I was waiting for you to say that.

Mr. Kent: In terms of the form of integration, senator, again we feel that the proposal as contained in the White Paper has both artificialities and restrictions attached to it that detract in large measure from its equity. Surely there are cleaner ways, as our Chairman has just indicated, of dealing with this particular problem. But we do feel that it is an important step forward that the Government is prepared to recognize that it is a desirable objective to eliminate that form of double taxation.

Senator Everett: I can see your concept working extremely well in the case of the closely-held corporation, where the shareholder is likely to wish to reinvest the money. If he takes it by virtue of a stock dividend, he is quite happy with that situation. But in the case of a widely-held or public corporation, it seems to me that you would be putting the mangement of that corporation under extreme pressure from its shareholders to pay all its earnings out in any one year, and it would be extremely difficult for them to get that money back in order to finance their projects.

Mr. Kent: We don't for a minute suggest that financing, in some cases, would not have to take a different form. I am sure the senator will have in mind that if the marginal rate of 50 per cent is maintained, that problem is, of course, very much lessened, presuming that we live with an approximate 50 per cent rate of corporate taxation, or corporate taxation in

the first instance, and the 50 per cent maximum rate in terms of the individual taxation.

The Chairman: Senator Everett, may I just interject? Mr. Capon and Mr. Kent have indicated a form or system under which the company would withhold the equivalent of what is the present corporate rate, but would withhold it on behalf of the shareholders. That would mean that the law could be written in such a way that it would not require the corporation to pay out all or any part of that money. If it did not pay out any part of the money, the taxpayer would have no creditable tax, but the company could exercise its own judgment as between the position of the shareholder and its need for retained earnings. Is that part of your idea?

Mr. Kent: Certainly, these pressures are in existance very much today, constantly, as to what proportion of earnings will be paid at any given time in any given year to any given group of shareholders.

The Chairman: You call it a fiction. One of the fictions in the White Paper now is that a closely-held corporation can elect to be taxed as a partnership. That does not mean it becomes a partnership. It is still a corporation.

Mr. Kent: That is not the only fiction in the White Paper, if I may say so, Mr. Chairman.

The Chairman: Didn't I say it was one of the fictions?

Senator Phillips (Rigaud): Was not business and industry at large comfortable with the present procedure, whereby the 20 per cent tax credit was given on dividends?

Mr. Kent: Senator Phillips, you are comforgable with any garment that you wear for a long time, because you come to know it well. We don't maintain for a minute that we have a perfect tax structure or one that is not capable of improvement or, in fact, even radical reform. Furthermore, I think it would be a capsule recommendation that it must be constantly updated, but nevertheless, within the framework of reference which our Chairman so capably defined in terms of its purpose.

Senator Phillips (Rigaud): The point I am making is that in order to overcome the inequities of double taxation are we not proceeding along a similar line of providing for tax credit on dividends?

Mr. Kent: It is certainly much more readily understood and much more easily administered, and for those reasons it commands a great deal of attention as to whether or not a further refinement along those lines is not perhaps the best route home.

Senator Phillips (Rigaud): Thank you. May I put one further question, Mr. Chairman? Directing myself to the Chamber, and with its ear to the movement of international capital and domestic capital, has the publication of the White Paper in its consideration had an effect, in your opinion, on the movement of outside capital into Canada and on the acceleration of export of capital from Canada?

Mr. Kent: I am not in a position to speak for the Chamber. I can only speak from my own personal knowledge, senator, and, in terms of that personal knowledge which runs from one end of this country to the other, I would say that it has had a marked effect already.

Senator Phillips (Rigaud): A marked adverse effect?

Mr. Kent: A most marked adverse effect already, yes.

Senator Phillips (Rigaud): Would you develop that, sir?

Mr. Kent: There have been both decisions made and decisions withheld which have had the effect of either withdrawing capital or of staying the hands of those who were going to make capital investments; and I know of instances.

Senator Phillips (Rigaud): That is the domestic capital pool you are referring to?

Mr. Kent: Both domestic and foreign capital.

Senator Everett: As a supplementary to Senator Phillips' line of questioning, Mr. Chairman, we know that integration will work for closely-held corporations, and I gather that the Chamber's position is that it will work for widely-held corporatiotns, and, if there is no shelf provision, it won't have the effect of causing or forcing widely-held corporations to pay out more than the normal dividend rate.

Mr. Capon: This is right. We are not seriously concerned on that score, provided the 50 per cent rate stays. The whole thing is a package and we look at it as a package and we say that this package will not cause a

serious problem in that area. On the other hand, we do see very real problems, if widely-held corporations are treated separately from closely-held corporations. If that happens we see complications and inequities and we are concerned.

Senator Everett: Your concept is that all corporations be treated the same and that integration be available to all corporations with no two-and-a-half-year shelf rule.

Mr. Capon: That is right.

The Chairman: Have you considered why the U.K. has abandoned this method?

Mr. Capon: Yes, we have, senator. It is very clear that at the time of their abandonment of this method they had to look around for some way to get more money, and the easiest way was to put double taxation on business. That why they abandoned it.

Senator Phillips (Rigaud): There are problems of administration, as you well know, Mr. Capon, in addition to that.

The Chairman: According to what we have read and from information we have received, there were terrific problems of administration, Mr. Capon.

Mr. Capon: That was before the computer was invented, senator. The mathematical problems of administration are a great deal less now.

The Chairman: Don't you think that, if the invention of the computer has led to greater facility to tax, maybe we should have an act of Parliament prohibiting its use.

Senator Molson: Mr. Chairman, may I draw attention to the second paragraph in the summary of the brief of the Executive Council of the Chamber?

It says:

> There is recognition of the need for tax reform at this time. While the White Paper has many constructive points, its total effect would seriously harm Canada's growth, prosperity, and employment. The Executive Council of the Chamber recommends that the government reconsider the total structure in the light of the following considerations and recommendations which are aimed at giving top priority to economic expansion, investment in Canada's growth and development and increased employment opportunities for Canadians.

This has been brought out very clearly by the evidence we have had from the various members. But on reading that, and I have just read it over again, it seems to me that there is an implication there that the Chamber considers this whole White Paper and all the proposals contained therein to be entirely unsuitable for the Canadian economy, in fact, and there is the inference there that this is a move towards socialism. I would just like to ask the Chamber whether that thought is in the wording of the summary?

Mr. Byers: To answer your question, Senator Molson, I think that is was already indicated by Mr. Capon and Mr. Kent earlier that the Chamber essentially thinks that the White Paper attempts to redistribute wealth whereas we feel that taxation should encourage growth. I think that is about the shortest statement I can make of the Chamber's position.

Senator Carter: On page 12, paragraph 39, dealing with capital gains and integration, you propose that gains of less than three years should be taxed at full income rate and losses should be allowed in full. "Where gains or losses are realized on assets held for more than three years, 50 per cent of the gains should be taxed and 50 per cent of the losses should be deductible." As an alternative to that proposal, I would like to get your reaction to a formula for capital gains whereby capital gains acquired in one year would be taxed at whatever rate was applicable to that income bracket, and then there would be, say, one or two points' deduction for every year that the capital gain was not realized—that is for every year it was held—so that those with say ten years would get a reduction of 20 percentage points. Would that not be a better way of handling the problem than the one you propose?

Mr. Kent: Senator, again I must repeat the premise on which we are prepared to accept any form of capital gains tax, and that is within the total package of integration. I may say that we considered very carefully the virtues and the complexities of an indexed system related to the shift in monetary values. This is, I think, inherent in your proposition. We rejected it for a number of reasons; administratively it is not that difficult, but there is a certain inequity if you are going to say that whatever capital gains tax is enacted should be completely barred from the effects of inflation, whereas all other forms of income taxation are going to, in fact, meet it.

It was one of the considerations in our mind when we set a three-year period to qualify for the lower rate. Of course it would make it much more clearly demarked as to what was and what was not capital gain. The other reason was that after that time, and it may be three, it may be five, it may be seven or it may be ten years before realization took place and again we stressed that there should be no taxation until realization has taken place. But if there is a substantial time period, there is justification for the tax at the lower rate of 50 per cent, and when I say tax at 50 per cent, that is taxation of 50 per cent of the gain, because during that period, after three years, inflation has burrowed into an indeterminate extent. So this was taken as one clean dividing point rather than a shifting dividing point although I am quite prepared to acknowledge that inherent in your proposition is the fact that it is one of greater refinement and perhaps greater merit.

Senator Carter: Does it not have the advantage of doing away with this five-year valuation to which you are opposed?

Mr. Kent: We reject that in its entirety. We say that the valuation is the market place and there is no capital gain until it is realized.

Senator Carter: But under the proposal which I have just suggested to you, there would not be any necessity for revaluation.

Mr. Kent: Then we are on all fours with you, senator.

The Chairman: We have sold that idea, so we should wrap it up.

Senator Everett: Continuing to deal with the capital gains recommendations, I think your recommendation is extremely well taken, but there is one aspect of it that bothers me. That is that on gains under three years you say that full income tax rates for both gains and losses, and over three years you say half the income tax rates—I am sorry—full income tax rates on half the gain and half the loss. Now, take the case of a man who is making $24,000 taxable income a year and he has a gain of $24,000 by virtue of buying a stock at, say, $10. That stock goes up and gives him that gain. Then in the following year the stock comes back down again to $10. If you treat gains as income and losses as a deduction from income, I think I am roughly correct that in one year, the year he enjoyed the gain, he would have an additional $12,000 tax to pay because his taxable income would go from $24,000 to $48,000. In the following year, if he had a loss of $24,000, his taxable income would be zero and he would have no deduction.

So, for making no profit, he would have no deduction at all, and this it seems to me would be the difficulty of using income tax rates as a means of taxing capital gains, and again I understand—and I wonder if the Chamber has given consideration to this—that the American concept is that capital gains are a separately taxed part of income. They are taxed at a flat rate so that in the case I have given you where a man in one year had a capital gain of $24,000, if the rate were 25 per cent, he would pay $6,000 and if in the following year he suffered a loss of $24,000, he would receive a deduction of $6,000. I wonder if the Chambrer has given consideration to this because it seems to me to be very important. I like your rules, but what seems to me to be the worst part of the capital gain situation is the fact that it is treated as income and added to income if you make a profit and deducted from your income if you suffer a loss.

Mr. Capon: In the first place what we have said, senator, is that we recognize that that certain kinds of gain, which we call capital gains if they result from speculative short-term transactions entered into for the purpose of earning that income, in fact results in income rather than capital gains. So we have said, recognizing also our recommendations on integration of income, that we do not argue against the concept on the short-term speculative gain that that is not income either. In your $24,000 case the income would go up to $48,000. In the next year the income would be zero, so the income tax would be zero, so you would get a credit, but not as much as the tax that he paid the year before in making the $24,000 profit. However, on the true capital gains side of the fence, yes, we agree that we would be better off competitively—and we have emphasized this competitive position—treating your true capital gain as a capital gain and taxing it accordingly. So we do not disagree with you there.

The Chairman: Mr. Capon, once you say there is such a thing as a true capital gain, then obviously it is not income.

Mr. Capon: That is right.

The Chairman: And if it is not income, why do you put it into an income area for taxation?

Mr. Kent: If I may speak to that, Mr. Chairman, because there were several points inherent in the senator's question, we say that it is of a basically different nature, not only because of the rules which determine it but also because of the recommended rate which would be applied to it, and I am sure it will not have escaped you that that rate would approximate under the 50 per cent to the rate we are accustomed to south of the Forty-Ninth Parallel of 25 per cent.

The Chairman: It had not escaped me, and I am perfectly aware of it.

Mr. Capon: I said that I was sure it had not escaped you. Also dealing with your point on timing, I am sure you must give cognizance to the fact that timing is in very large measure in the hands of the individual in terms of when he will realize a profit or accept a loss, because again in cleaning ou the underbrush we took out such things as homes, personal property and such things which had no business in there in the first place.

Senator Everett: But the point surely still holds, the example of a person having a capital gain in one year and an equal capital loss in the second, whether you use half the income rate, which I agree approximates in the example we used, 25 per cent, nevertheless you have the man being taxed 25 per cent on his gain, and in the particular example having no tax deduction on account of his loss.

Mr. Kent: He would have the offsetting deduction for the tax that would have been applicable on his ordinary income.

Senator Everett: But he did not make any money that year.

Mr. Kent: Your man is wiped out as well?

Senator Everett: Yes, so that he is being asked to pay $6,000 tax without making a profit.

Mr. Kent: There is no doubt you can always take any example dealing with tax legislation to get a rather extreme result, but there are also inherent in this whole proposal averaging provisions which again would ameliorate the very situation you are talking about.

The Chairman: But the basic difference between having a fixed capital rate and making it subject to the income tax rate is that the income tax rate you must look at as a variable rate, and that is the basic difference.

Senator Phillips (Rigaud): Mr. Chairman, I have no confidence in this 50 per cent assurance. I asked a Government witness about a constitutional guarantee and it invoked merriment when I put the question to him.

Under these conditions would the Chamber of Commerce be unhappy if we concluded that it would be best to follow the American system of a flat rate?

Mr. Kent: I think we would be unhappy if you concluded any rate was applicable to a capital gain.

Senator Phillips (Rigaud): But supposing we concluded that it was applicable?

Mr. Kent: If you concluded that it did form part of the whole package, you would have to look at it within the framework of the overall recommendation.

Mr. H. P. Crawford, Member of Tax Reform Committee, Canadian Chamber of Commerce: If I may speak to that point, my understanding of the American system is that you include half of your gain in income. The rider is that the tax on half that gain cannot exceed 25 per cent. There have been recent amendments that certain large types of gains can go up to 35 per cent. We are premised on the 50 per cent maximum rate. If we lost that, I am sure we would say it has to be a maximum rate of 25 per cent.

Senator Hays: Could Mr. Gilmour tell us about the American system, because I am interested in this point?

Mr. Gilmour: The American and British systems, Senator Hays, set aside what are called short-term gains and what are termed long-term gains. The division in the United States between a short- and a long-term is to be a period of holding of six months, and the short-term gain ordinarily falls into income which, of course, is our system today. If you get out and speculate in cattle or oil leases, or whatever you do in Calgary...

Senator Hays: It is not adultery.

Senator Phillips (Rigaud): As far as I know, there is no tax on that yet, sir, but if you go in for short-term benefits or gains, the tax collector here will tax you on that income, which is the reason why I have said there is no such animal as a capital gain to a corpora-

tion today in Canada, although there are exceptions, as we discussed. Essentially, there are very few capital gains to individuals. But in the United States the short-term speculative transaction falls into income. The longer-term gain is segregated and, of course, the great difficulty in the United States is to distinguish between what is a revenue or speculative gain and what is a capital gain. Really, they just do it on a rough length of time. There are all kinds of arguments in practice and all kinds of maneouvres in which you try to get an income item thrown into the capital gain, because the Americans have, both with the individual and with the corporation, a graduated rate of tax. By that the individual rate goes up in chunks, as ours does. The corporation has a two-tier tax the same as our present taxes, but when you have a long-term gain, then you pay a tax of 25 per cent upon it.

Essentially, that is what the British have adopted. And where the problem comes about is anybody can explain the theory of capital gains tax in five or 10 minutes and it makes a beautifully acceptable system, just as, with respect to these gentlemen, integration makes a beautiful theoretical illustration, but it does not quite work that way—with respect, gentlemen. We have both in the United States and Britain this attempt to tax the longer-term gain. To my knowledge, either of those countries ever attempts to tax an unrealized gain. They stick to the realized items, and where the complication sets in, we can say and it is quite easy for me to say that if you bought and sold some speculative securities and made a profit, that would fall into income, but when you get into the corporate field of corporate reorganizations and changes in capital structure, of necessity the Americans have adopted the most complicated legislation in the world to deal with the vast problems that will certainly arise in practice.

Now, our White Paper says that we are going to do this awfully simply. We are going to dump everything into income. Of course, the White Paper looks to gains. There is the point that Senator Everett raised, that if you take a loss and you include it in income then because of our graduated rates the individual will always pay more tax on a gain than he will recover on a loss, because he is starting at the level of his earned income. One goes up and one comes down.

In theory, if you have a flat 50 per cent rate—if it attacks everything at 50 per cent—then you get away from that. But, to use Senator Everett's illustration, if you have an income of $24,000 then obviously you are not paying 50 per cent on that $24,000...

Senator Beaubien: It is a new scale.

Mr. Gilmour: I will ask my human computer here what it is.

Senator Molson: It is 40 per cent.

Mr. Gilmour: Let us take 40 per cent. I think you are a little high, senator, but we will take 40 per cent. An additional capital gain of $24,000 would be taxed under the present rates at quite a bit more than that. Then, if you had a loss of $24,000 in the following year, of course, you are starting at a total deduction of $24,000, so you get back the tax from zero to $24,000. You economize to that extent.

The Chairman: You get it back by not paying it.

Mr. Gilmour: Well, you have a deduction for only...

Senator Everett: You just have no income.

Mr. Gilmour: Of course, it is a theoretical capital loss. It is not income. But where the Americans ran into their trouble was that in a bad stock market crash the losses incurred could wipe out the earned income of the country, and in effect bankrupt the country. They have always had a separate tax for the longer term gains, but there used to be, and there is still, a provision that if you keep on running into long term capital losses then you can—at one time you could knock the whole net capital loss off your earned income. This is what nearly bankrupt the United States in the early thirties. They have limited that so that today I think you can deduct your net long term capital losses from earned income at the rate of about $1,000 a year, and that is after taking advantage of every trick.

But, the United States tax legislation has each year become more and more complicated, and is getting and is continuing to get worse. The general opinion down there is that the capital gains taxation has not collected too much, but it surely has halted business in many ways.

In Great Britain I do not think they have had enough time—they have not had nearly as much time as they have in the United States—to be able to make an assessment, but the people who comment upon it say that British industry is being bogged down up to

its neck in a muddy morass of paper. There is a delightful rumour going around, which I do not know whether is true. It is to the effect that the tax assessors of the internal revenue department are going on strike for what used to be called danger pay in the navy, because they have to deal with capital gains. I cannot vouch for that.

But here we are walking into capital gains taxation. We have this appalling mess of legislation in the United States, and it is nearly as bad in the United Kingdom. I warrant that instead of having the roughly 150 sections in our present act we will end up with 1,150 sections dealing with capital gains alone, and without the production of much revenue.

The Chairman: Are there any other questions?

Senator Connolly (Ottawa West): Mr. Chairman, I have two questions, one of which is very short. I should like to ask the chamber whether they have any figures as to how many people there are in the so-called middle income group who might be unionized.

Mr. Kent: We have no such figures.

Senator Connolly: Could you make an estimate of the number of people in the labour force. Would it be a substantial number?

Mr. Kent: I would have no basis for giving even an informed opinion on that, senator. It would, of course, depend upon many things. Where does your middle income group start, for instance?

Mr. Crawford: I think it would start at around $5,000. If the middle income group starts there then in the highly organized industries, such as brewing, steel, mining, and automobiles, there would be a substantial number.

Senator Connolly (Ottawa West): We have been talking a great deal about the justice or the equity, so to speak, of the proposals in the White Paper, particularly in reference to capital gains. The other aspect of it, to which the chamber has referred, is the curb that is put, first of all, on savings in Canada and the development of pools of money for investment and, secondly, the lack of incentive for foreign investors to come here and invest. Would you think that the thrust of the White Paper in this respect may have originated because of concern over the size of foreign ownership of Canadian business. Do you think the Government is trying to get at this problem, and to reduce the amount of foreign ownership, through the tax base?

Mr. Capon: We would not have reached that conclusion. We certainly did not assume or believe that there was any intent in the structure of the White Paper to get at the problem of foreign ownership.

Senator Connolly (Ottawa West): But it is going to have an effect on it, is it not?

Mr. Capon: It might have an effect on it. To the extent that it has an effect, it would be caused by the fact that it would be making investment in Canada less attractive, and that would be the same for Canadian investors as for foreign investors. It would not matter which.

Senator Connolly (Ottawa West): I agree.

Mr. Capon: It would tend to discourage the foreign investor, but really it would be discouraging investment *per se*. We certainly did not assume that the Government was trying to follow that route to solve the foreign investment problem.

Senator Connolly (Ottawa West): No, but it is conceivable that that could have been behind the philosophy.

Mr. Crawford: If you look at the resource companies, which are made up of a high level of income from foreign sources...

Senator Connolly (Ottawa West): Or capital investment from foreign sources.

Mr. Crawford: Yes. These companies tend to become a more favourable investment for the non-resident than for the resident in relation to the tax. That seems almost to be competing with what appears to be the developing Government policy on ownership of all our natural resources.

Senator Connolly (Ottawa West): Generally speaking, the effect is to discourage the availability of capital for development.

The Chairman: Senator Connolly, Mr. Byers wishes to direct your attention to a statement of the position of the Chamber of Commerce on the question of capital gains.

Mr. Byers: In the brief submitted to you we have indicated that if capital gains must come in, these are our suggestions. However, in the Chamber's statement of policy, which is

approved annually at our meeting, there is very definitely as a basic policy:

> For all of the above and many other reasons and notwithstanding the recommendation of the Royal Commission on Taxation, the Chamber is opposed to the introduction of a capital gains tax in Canada.

That is the basic policy. Then the other is "but if something has to be done."

Senator Hays: That is what I was concerned about.

The Chairman: That must be comforting to you, Senator Hays.

Mr. Byers: There is a basic, recorded principle of the Chamber that is opposed to capital gains.

The Chairman: If there are no other questions, we thank the Chamber for the assistance you have given us today. It is now 20 after 12; it would be a shame to start a brief for 10 or 15 minutes. My suggestion is that we adjourn until 2.15 p.m. and then we will work through until we finish the briefs.

The Committee adjourned until 2.15 p.m.

Upon resuming at 2.15 p.m.

The Chairman: Honourable senators, before we proceed to hear our first submission this afternoon I should like to say that a brief was sent to us which ties into the brief from the Canadian Chamber of Commerce. The people submitting the brief indicated that they did not propose to appear unless we invited them and it was thought necessary. However, they did ask that their brief might be put into the record in its relationship to that of the Canadian Chamber of Commerce. The brief I refer to is from the Prince George Chamber of Commerce, and it is in line with that from the Canadian Chamber of Commerce. I would ask leave of the committee that it might be printed as an appendix to the proceedings today. Is that agreed?

Hon. Senators: Agreed.

The Chairman: Our first submission this afternoon is from the Canadian Dental Association. Dr. W. J. Spence, the President-elect, is here and has a panel with him. Dr. McIntosh, the Executive Director, will introduce the panel, and I believe will make the first statement.

Dr. W. G. McIntosh, Executive Director, Canadian Dental Association: Dr. Spence will speak first after I have finished the introduction.

The Chairman: Very well, it is now in your hands.

Dr. McIntosh: Mr. Chairman, honourable senators, it is a pleasure for me to be able to introduce the panel for the Canadian Dental Association. On my immediate right, as the Chairman has indicated, is Dr. W. J. Spence, who is the President-elect of the association. Next to him is Dr. Henri Brouillet, who is our immediate past President. Next we have Mr. Martin O' Brien, who is our legal counsel and has been of great help in the organization and drafting of our brief. At the end is Dr. Harold Beach, who is Chairman of our Sub-Committee on Taxation, and is also the President of the Ontario Dental Association.

You will have noticed from our brief that there are approximately 7,000 dentists in Canada, and it is on behalf of these 7,000 dentists that we appear before you today, and thank you sincerely for the privilege of so doing.

With your permission, Mr. Chairman, Dr. Spence will introduce our brief to the honourable senators and highlight its main recommendations.

Dr. W. J. Spence, President-elect, Canadian Dental Association: Mr. Chairman, honourable senators, our brief deals primarily with the dentist as a member of the health profession in Canada and as a middle income tax payer. The latter aspect of this subject as it bears on the White Paper will, I am sure, be dealt with by many briefs, so primarily we would like to go over those parts of the brief that deal with the dental profession's particular problems arising out of the White Paper.

The dentists of Canada are primarily interested in the recruitment of young people looking into this profession and also in maintaining or retaining the members of this profession in Canada where we feel that their services are vitally needed. We are being told constantly that perhaps we should be able to increase those services.

With your permission, Mr. Chairman, I would like to read the introduction to the brief, perhaps go over it and highlight some of the recommendations, then, along with my colleagues, we will try to answer in the best way we can any questions that the honourable senators may have.

I will read the introduction to the brief.

On November 7, 1969 the Honourable E. J. Benson, Minister of Finance, released a White Paper outlining the Government of Canada's "major proposals for reform of the income tax structure". The Government has welcomed public discussion of the proposals and indicates in the White Paper that "The government believes that taxpayers and those who represent them in Parliament and in provincial legislatures should contribute actively at an early stage to the formulation of policies that so directly and vitally affect them. In addition, the Minister of Finance has on numerous occasions invited comments and "constructive" criticism on the proposals.

In this brief, the Canadian Dental Association is answering the minister's request by settting forth its comments. In preparing the brief, the association recognizes that it acts on behalf of the dental profession as a profession and also on behalf of the dentists as taxpayers. With this thought in mind, the following comments are submitted not only in relation to the effect of the proposals on the profession and on individual dentists as taxpayers, but on the quality and availability of dental services for Canadians.

It is the associations's position that the implementation of the White Paper proposals will have a detrimental effect on the dental profession. Dentists will face increasing taxes, with no allowances for educational expenses incurred either before or after graduation, and payment of tax when cash is not available. They will be required to revalue their shares in widely-held Canadian corporations every five years and include for tax purposes in that year any resulting gain.

The association has no objection to equitable tax reform but believes that the dentists should have the same opportunities to provide for his future as does the senior civil servant or executive of a corporation. Today, these employees are retiring with annual pensions of $15,000 or more. A dentist must provide for his own fringe benefits and security, and for him to purchase a guaranteed annuity of $15,000 requires a substantial outlay which he must pay out of "after tax" income (aside from the annual maximum which can be paid into a registered retirement savings plan).

The effect of the proposals, particularly that of revaluation, will make it difficult for a dentist to accumulate the funds he needs to provide an adequate retirement income. Dentistry is a physically and emotionally demanding profession and the association, therefore, is opposed to tax measures which would discourage retirement at an appropriate age.

In the White Paper the Government states that "a number of goals and standards have guided the government in its approach to reform. They include a fair distribution of the tax burden based upon ability to pay; steady economic growth and continuing prosperity; the recognition of modern social needs; widespread understanding of and voluntary compliance with tax laws, combined with enough detail to block loopholes; and, finally, a system that can and will be used by the provinces as well as Canada."

In this brief, the association intends to express its views as to whether the proposals do indeed carry out the above aims of tax reform.

I would like to highlight from page 2, the summary of recommendations. The first point I would like to highlight which is a concern to our profession is the idea as expressed in the White Paper of using the accrual basis of accounting as opposed to the present cash basis. This cash basis which is now permitted to dentists under the present law we feel should be repealed. The prime reason for this is that a young graduate having just completed his education and taking on a considerable financial commitment in the establishing of his practice would be in a difficult position to pay his tax on an accrual basis, while if he was paying taxes as he was paying the fees he had earned, he would not be in this difficulty.

The Chairman: On that first one Dr. Spence simply means that if you go to an accrual method you have done some work, but the accrual basis would require you to evaluate the work and bring that evaluation into your income for the year. At that stage you may not have settled all the amount of your account and you may find that even when you render it there is some question about its going to be paid at all or by instalments. Yet, before you have even billed it up you are going to have to bring it into your income for the year.

Dr. Spence: Right. In an established practice where a man has been practising for a number of years and his income is inconceivably at the reasonable level it will remain so until perhaps it declines and he would not be in that difficulty. The new young man would

be in real difficulty with this because he would be paying tax for which he has not got the money to pay it. There is one other point which perhaps should be mentioned here and that is the dentists themselves are concerned about the additional staff requirement in looking after a rather complex bookkeeping system forced on them by the accrual method of paying this tax.

The Chairman: You say that the man who has been in practice for some time would not be affected in the same way? He is bound to be affected because in order to pay taxes on income before he gets it and before he has billed it, he is going to need either good credit at the bank, for which he will have to pay for or he will have to have working capital.

Dr. Spence: This is true.

Mr. M. L. O'Brien (Counsel, Canadian Dental Association): A businessman can borrow on his inventory or his accounts receivable.

Senator Phillips (Rigaud): As a matter of fact, on an accrual basis it is not accounts receivable when you can't even collaterize it on a bank loan.

Dr. W. G. McIntosh (Executive Director, Canadian Dental Association): There is another important point in this age of increasing prepayment programs for health services, including dental services. A fair number of these tend to pro-rate the dentists' fee so he is being taxed on a full fee, but paid on a pro-rated fee, which is some percentage less. This does not seem like an equitable way of handling it.

Dr. Spence: Point No. 2: The Canadian Dental Association is concerned about the regulations as regard educational expenses and feel that the tuition fees for graduates and post-graduate programs and continuing education courses recognized by provincial licensing bodies should be allowed as a deduction whether the course is taken inside or outside of Canada. But the reason we say inside or outside of Canada is that there are many specialist courses in dentistry which are to the advantage of the practitioner and to the public he serves. They are not available at our Canadian universities and many of us do or have gone to American universities or other places to take these courses. The travelling and lodging expenses of a person who is going to attend a graduate, post-graduate or continuing education program should also be deductible. We feel that if the deduction is not utilized, the taxpayer should be permitted to carry the expense forward against future years' income. The reason for this is that if a man goes and takes a two year graduate course he must either relinguish his practice for that time to another practitioner or give up his practice entirely and therefore has little or no income during the period in which he studied. Any expenses allowed to him would then be accrued against no income during those two years. We feel that the present reduction of convention expenses should be retained provided that these expenses are reasonable in the circumstances.

A convention of dentists is primarily an exchange of professional information which people in medicine can carry out through their hospital affiliations, people in law through their court affiliations, but where dentists are in their own little offices they have this as an opportunity to further their own education and exchange of information with their colleagues. We feel that the incentive created by the non-taxation of bursaries and fellowships should be retained. If fellowships, bursaries and research grants are to be taxed, then the travelling, lodging and other expenses incurred by the taxpayer in utilizing such grants should be deductible.

Senator Burchill: Going back to number two, at the present time your convention expense is deductible?

Dr. Spence: For two conventions per year, yes sir, one of which may be out of Canada.

The Chairman: But when you were dealing with educational expenses, Dr. Spence, tuition fees for graduate and post-graduate programs, et cetera, those are not deductible now. Am I correct?

Dr. Spence: That is correct, sir. Not in Canada.

The Chairman: So what you are in that sense asking us to do is, if we think it proper, to recommend something that should be included in the White Paper as part of the proposals?

Dr. Spence: Yes, sir.

Senator Laird: And you would, of course, afford the same privilege to other professions, I presume?

Dr. Spence: Absolutely.

Dr. H. N. Beach, Chairman of the Sub-Committee on Taxation, Canadian Dental Association: Another point is that one province, Alberta, has already promulgated regulations requiring dental specialists who wish to renew their licence after five years to provide evidence of a minimum of 200 hours of lectures, clinical and laboratory training, and so on. So he is obligated to take this post-graduate training to keep up his licence.

The Chairman: That certainly would appear to come under the heading of money laid out to earn income.

Dr. Spence: We are Canadians in Canada dealing with a Canadian problem. As an example of this, during the last five years I have taken two graduate courses where I was the only Canadian and the only individual who was not allowed these expenses. As far as medical expenses are concerned, we feel that the 3 per cent qualification limit for medical expenses sholud be reduced in order to facilitate the deduction of dental and other health expenses by taxpayers in all income brackets. We feel that this 3 per cent qualification is no longer a valid percentage, because of the Government assistance in other health expenses, which do not apply to dental fees.

The Chairman: You mean that Medicare does not take in dental care?

Dr. Spence: Except for certain operations done by an oral surgeon in hospital.

The Chairman: What do you suggest instead of the 3 per cent, or do you just suggest it be done away with?

Mr. O'Brien: We have not given too much thought to the actual percentage, but we would start with zero and work up. With today's inflation, when we talk about 3 per cent of an income of $15,000 it is $450, and you would have to spend $450 in dental bills and other expenses before it is deductible. I would say one per cent.

The Chairman: Having regard to the scale of income nowadays, the 3 per cent produces a substantial amount and it is quite unlikely that dental fees would run that high.

Mr. O'Brien: That is right.

Dr. Spence: The Canadian Dental Association feels that all taxpayers should be permitted to average incomes on the same basis or, in the alternative, that they should be able to make payments into a registered retirement savings plan in the same manner as authors and professional athletes. A dentist should be permitted to carry forward his educational expenses against future years' income.

The Chairman: When you refer to income average, how would this work out? Would you care to illustrate it? Do you mean on a three year basis to establish a rate, or what? This is on the basis that you might have ups and downs in any case?

Mr. O'Brien: That is right. We think that the averaging provision suggested in the White Paper is very illusory and that there is no real benefit there.

The Chairman: The suggestion is that you have to increase your income in a particular year by at least a third in order to qualify for the averaging?

Mr. O'Brien: And when you do get the averaging you really do not get an awful lot of benefit out of it. I think this is illustrated by one of the tables to the White Paper.

The Chairman: Would the present averaging satisfy you?

Mr. O'Brien: No, not if you are going to bring capital gains into it. The Carter recommendation that you have a registered retirement savings plan and pay your fluctuations in income is probably the most equitable way you could do it on 5 per cent, the same as farmers and fishermen today.

The Chairman: Can each one not register a retirement savings plan?

Mr. O'Brien: Yes, but we can only put $500 a year into it.

The Chairman: What is your suggestion? That the amount be increased?

Mr. O'Brien: Very definitely.

The Chairman: By how much?

Dr. Spence: We have discussed this problem, sir. I would say a minimum of $3,000, which is only taking it to the amount of an employer-employee contribution in a business.

The Chairman: Yes. Have you reckoned in any way what kind of benefit you might get out of that retirement savings plan on retirement?

Dr. Spence: Roughly at age 65, if a man graduated at age 24 and continued with a plan he would be able to buy an annuity at today's price of about $20,000.

The Chairman: Twenty thousand dollars a year?

Dr. Spence: Yes, sir.

Senator Laird: You speak of an appropriate age for retirement for dentists. What do you consider to be an appropriate age?

Dr. Spence: I think this varies with the physical and mental capabilities of an individual, one to another, and his health problems. However, dentistry is rather demanding physically and some people wear out, quicker than others.

Senator Laird: Have you any averages of when dentists retire normally?

Dr. McIntosh: Sixty-five is a fairly average age.

Senator Hays: How does that pension work out, from 24 to 65?

The Chairman: The idea is if he contributed $3,000 a year then at 65 he would have enough money to buy an annuity which would produce $20,000 a year for him.

Mr. O'Brien: Dentists above that age bracket now attempting to purchase such an annuity at age 35 would have to put in $4,735 a year which means he cannot fund it out of $3,000. If he is aged 40 he has to put in $6,355 a year, and of course it goes up at age 50, when it costs $12,388.

The Chairman: It is only the dentist, then, in the very early years of his practice, who could create an annuity or provide the means for an annuity of $20,000 a year by paying in $3,000 a year. Of course, the earliest period is the time when he is rather short of income.

Dr. Beach: That is right. That is why we are opposed to revaluation, because that will get the dentist in, say, the 50 year age bracket...

The Chairman: I think that is why you would be opposed to capital gains tax too.

Mr. O'Brien: We are jumping ahead here, but I think we might deal with this subject. I referred to the age 50, when it would cost $12,388 a year. If we pre-suppose that man was an employee of a company and the employer wanted to put in a pension plan for his employees, he is entitled to put $1,500 a year and the employee is entitled to put $1,500 a year, which is $3,000 a year.

The Chairman: And that is deductible.

Mr. O'Brien: That is deductible. However, it requires $12,388 a year to give the employee that benefit, so every three years after the plan is established he gets his certificate under section 76 of the Income Tax Act, which creates what is known as a past service sufficiency, which entitles the employer to make a total lump sum payment into the plan to fund this sufficiency. While we say an employee is entitled to $3,000 deduction, in fact he is entitled to an awful lot more, and the employer is entitled to an awful lot more. Under the Ontario Pension Benefits Act, if there is an unfunded deficiency it must be funded because the regulations require such funding, so notwithstanding the employee is 50 years of age and it requires $12,388 a year, he will have a full pension at age 65 and all the payments by the employer will be deductible.

The Chairman: Are you suggesting that that benefit should be translated in terms that would help the dentist by combining his capacity as that of employer and employee so that he can get the past service benefit contribution?

Mr. O'Brien: Definitely, plus something somewhat similar to what the Carter Report said, which was $12,000, which you put in any year that you wanted. We do not think $12,000 is high enough, but something in that order.

The Chairman: Of course, the past service contribution would be deductible under the statute in relationship to the employer and employee.

Mr. O'Brien: That is correct.

Dr. Spence: In regard to the United States-Canada tax, on page 4 of the recommendations, we feel that a full review should be made of the tax burdens proposed on middle income taxpayers in the United States and in Canada in order to avoid the loss of qualified dentists to the United States for tax reasons.

Dr. McIntosh: We think this is a very important item. We frequently hear of the brain-drain, and certainly this is applicable within our profession, as it is in others. In

recent months there has been increased evidence of dentists investigating the possibility of moving to the States because of the tax advantages. We therefore think that in terms of maintaining and improving a service to this Canadian public, this item has very important implications.

Senator Laird: How easy is it for dentists to get a visa for admission to the United States?

Dr. McIntosh: For most of the states it is very easy. There are a few in which he has licensing problems, where he may have to try examinations, and may have to spend another year in school, but for most of the states it is a relatively easy process at the present time.

Senator Laird: What about citizenship? Is he required to become a citizen of the United States?

Dr. McIntosh: In due course, but he does not have to immediately.

Senator Hays: Do you have any figures of the number of dentists who go to the United States each year

Dr. McIntosh: They are not up to date. Four years ago we had figures which would indicate a movement of approximately 100 a year. I have not figures more recent than that.

Senator Burchill: I know that in some sections of Canada, especially where I live in the Province of New Brunswick, there is a great shortage of dentists. In your brief you indicate the same condition exists in the United States. Is that right?

Dr. McIntosh: To a lesser degree in the States, but still they say they need more dentists.

The Chairman: Even in Toronto, which you would think would be a centre where they might congregate...

Senator Hays: Why?

Senator Hollett: A good question.

The Chairman: It is difficult to get a dentist.

Senator Haig: Is the number of dentist graduates gradually increasing per year? How many dentists have you got in the Canadian Dental Association this year compared with a year ago?

Dr. McIntosh: Our Canadian total has been increasing at about 200 per year over the last four or five years. Previous to that we were going down a little, because we were not turning out as many dentists as we were losing for various reasons that then applied. For the last four or five years we have been gaining at the rate of about 200 a year.

Senator Haig: Net?

Dr. McIntosh: Net.

Senator Phillips (Prince): Following your statement that there is a tendency for dentists to go to the United States, or might be as a result of the White Paper, how many of this year's graduate class are writing their exams?

Dr. McIntosh: I am sorry, I do not have that information.

Senator Hays: Do you have many dentists from Australia and New Zealand? Is there a movement?

Dr. McIntosh: Not on a permanent basis. We still have a fair number who come for graduate training, but very few who come to stay, to set up permanent residence in Canada.

The Chairman: They have to write qualifying examinations, do they not?

Dr. McIntosh: Yes, they do.

The Chairman: Do they have to attend lectures?

Dr. McIntosh: It depends on their own ability now. They are able to try provincial licensing exams directly they arrive in this country. If they are able to pass them they are given a licence immediately. If they are not able to pass them they may be required to take a year or even more in one of our universities.

Senator Carter: What is the situation between one province and another? If you are registered in one province can you practise in another province?

Dr. McIntosh: No, sir, you cannot. Each province has its own licensing board. A graduate from, for example, the University of Toronto licensed in Ontario who does not take his National Dental Examining Board examinations is not eligible to go to any other province without subjecting himself to that province's provincial licensing exams. Dr. Beach here is also the Registrar-Secretary of

the National Dental Examining Board, and if you would be interested in more of the implications of that board I am sure he could fill you in more accurately than I. There is that provincial autonomy yet in terms of licence.

Senator Carter: Does that restrict each province to develop its own personnel? Does it restrict movement between one province and another?

Dr. McIntosh: I think it does to some extent, yes.

The Chairman: Are there any other questions you want to ask Dr. Beach? Otherwise we will continue. Dr. Spence, would you care to continue?

Dr. Spence: At the bottom of page 4 are our recommendations on expenses. Section 21(2) of the Income Tax Act which denies the proprietor or partner in an unincorporated business to deduct remuneration paid to his staff should be repealed. We have instances where dentists employ their own wives in one capacity or another in their practice. If it were a small business he would be allowed to deduct the remuneration paid to his wife, but in a dental and I believe the medical practice this is not allowed.

The Chairman: Even though the wife might be a dental nurse?

Dr. Spence: That is correct.

Mr. O'Brien: To correct your statement, if the business is incorporated the deduction is permitted. If it is unincorporated the deduction is not permitted.

Senator Laird: A dentist cannot incorporate?

Mr. O'Brien: We cannot. It becomes rather ridiculous. A doctor in office No. 1 hires the doctor in office No. 2 and vice versa.

Dr. Spence: With regard to expenses the association feels that entertainment expenses should continue to be allowed as a deduction provided that they are reasonable in the circumstances.

The Chairman: Have you any regulations against dentists advertising?

Dr. Spence: Yes sir.

The Chairman: Would you tell us what it is.

Senator Phillips (Rigaud): Where in God's world can a dentist entertain you when you go to see him?

The Chairman: He might take you out for a dinner and give you a chocolate bar or peanut bar then you have dental problems.

Dr. McIntosh: A dentist is ethically not allowed to advertise. He is restricted in the size of the sign he can have out in front of his office door. He cannot put notices in the newspaper nor can he send out flyers and so forth.

Senator Hollett: Why?

The Chairman: It is not ethical and those are the rules of the organization.

Dr. McIntosh: And the licensing board in the provinces. It is more than just ethics, but a licensing regulation. This is particularly true of the specialist, but to a lesser degree the general practitioners as well. Their means of contacting new patients is through referrals, such as one patient telling another and so on. In this sense we feel there is a legitimate entertainment or business expense justified in this area.

The Chairman: The specialist might entertain the general practitioner.

Dr. McIntosh: That is correct, sir.

The Chairman: That might lead to referrals.

Senator Haig: You refer to convention expenses in these recommendations.

Dr. McIntosh: Yes, we do. It is on page 3 of the recommendations, the second one from the top of the page.

The Chairman: Will you continue, Dr. Spence.

Dr. Spence: Page 5 of the recommendations. The maximum deduction of $150 for employment expenses should be revised to permit a claim in excess of $150 provided detailed records are maintained. The reason we have included this in our brief, gentlemen, is that there are a number of dentists in Canada who are salaried and who, in order to keep up the professional standards, would want to belong to certain professional organizations, receive certain professional journals and so on. The value of this would be somewhat in excess of this allowable $150. We feel, particularly, with men in that position that this ceiling is perhaps a little unfair.

We also feel that the moving expenses of a dentist should be deductible. I believe this is allowed for employees. It is a question of when a dentist is changing a job. If he moves from Toronto to Calgary he is still practicing dentistry, but must change his location, office, home, et cetera.

The proposal to prohibit the deduction from other income of a loss resulting from the ownership of rental property should not apply where the loss occurs from the ownership of rental property in which the landlord carries on business, or in this case, his practice.

Senator Haig: If he owns the building and the building takes a loss in which he has an office he should deduc that loss?

Mr. O'Brien: The White Paper proposal has been to counteract the loop hole in the Act. What was happening is that high income tax payers would purchase depreciable property. As long as you hold property any time of the year you are entitled to a maximum capital cost allowance. You write it off against your other income. There are other situations when a man could make $60,000 a year. He has bought a large enough building to show zero income for a year. The White Paper decided to block that loop hole by saying that any loss created on the operation of real property cannot be taken back against other income.

The Chairman: What if he lives in the building?

Mr. O'Brien: There is no limitation in it. If you have a loss of rental property you cannot write it off against other income. If you have a building in the early years when the capital cost rates were high, because your cost base is high, you are apt to produce a loss. Normally, rental property would take five or six years before it shows an income and then it shows a considerable one. If the White Paper proposal goes through, even though we own the building and practice in it we cannot take that loss against other income. We think we should be able to.

Senator Everett: When the architects were here they were of the opinion that there should be no amendment to the present law, nor any way that a taxpayer should be permitted to deduct depreciation from other income if the income from the asset does not cover it. Can you tell me what the view of the Dental Association is in that regard?

Mr. O'Brien: I do not know whether I could give you the view of the Dental Association, but I could certainly give you my own opinion. My view is that there is a tax benefit here that is not warranted. I think the architects are making that recommendation and they certainly have their own axe to grind. The more buildings they put up the more depreciation is available and more losses they can write up.

Senator Everett: We are satisfied that most people here who have appeared have an axe to grind.

Mr. O'Brien: Not necessarily, because we do not.

The Chairman: Since this has projected some discussion let's hear Mr. Gilmour's comment.

Mr. Gilmour: Gentlemen, with respect, I seem to be finding myself a little at variance this morning with all our distinguished visitors. I would like to take some mild exception to the use of the word "loophole" when you purchase a building. They way our present act works is that if any of us here, as individuals, decided to purchase for ourselves, as individuals, one of those high-rise apartments that is springing up in English Bay in Vancouver—the reason that I mention that is because I have a lot of friends who are suggesting that I purchase one because I spend so much time in Vancouver. You would not put up any capital if you could borrow it and then you would be in a position where you owned an apartment building that might have cost a million dollars. You have got a tremendous debt against it and of course if the thing goes sour you probably would go bankrupt, but on the other side of the coin you have your rental income which is your personal income and you have against that the interest that you pay on the first, second and third mortgages. You then, of course, are entitled to a capital cost allowance, probably at five per cent annum computed on a diminishing balance basis.

At first it is quite wonderful, if you have a professional income or an earned income of let us say $50,000. You would then add to that your rental income, whatever it may be and then you would subtract the mortgage interest on all of the mortgages and your capital cost allowance for the first year would be five per cent of one million dollars which I think is $50,000. The next year it would be five per cent of 950 and then the curve drops pretty fast. Within probably seven or eight years you would be running a net profit on your

building and that net profit gets added on to your earned income and you start paying through the nose on your profits.

As we were suggesting with regard to capital gains this morning and more properly Senator Everett was discussing them, the benefit of your interest and the benefit of your capital gains comes off your earned income so that you get a diminishing tax relief as you come down. Of course, after you start running out of capital cost allowance you start earning net rentals. It goes right on top of your earned income and you start paying through the nose on it. Now, apparently like so many things in the White Paper, inability for a few years to deduct a capital cost allowance of a substantial amount is again—it is another sinful action. There are all kinds of sinful actions in the White Paper.

The Americans tried the same thing. Some of their tax legislators felt that it was not proper to give you the quick capital cost allowance. Down there they call it double declining depreciation, whatever that is. It works out the same as our diminishing balance. They called a halt to it, but then private building very quickly called a halt also.

So that it has been proved in the United States that this is pretty shortsighted legislation. Our White Paper proposes the same thing. My only purpose is to say that this ability under our present law to deduct a diminishing balance capital gain is not really tax reduction. It may be tax deferment, but it is a deferment so that you will have the privilege of paying a larger tax when you come into an income tax position, and I do not really think that is a tax gimmick.

The Chairman: There is also the possibility of recapture.

Mr. Gilmour: Yes, if you sell it again you will get clobbered. So I do not particularly know why we have suddenly become very emotional about curbing this. These medical gentlemen here, as is quite frequent in smaller cities in Canada and, I guess, perhaps in bigger ones too, find that it pays to buy your own office building, rent out the part you do not need, and in effect live rent-free in the portion that you occupy. You have to include in your income the rentals you get from you your separate tenants, so you get the deduction of mortgage interest and capital cost allowance for a few years. That is very good business. Then later on it ceases to be that. Under our White Paper we say naughty, naughty, you are not to have that for that few years. So the impact will be why should you risk building or buying an office building if you are not going to get any benefit out of so doing?

The Chairman: To be consistent, the recapture provision should be repealed.

Mr. Gilmour: That is the purchase when you sell the building.

Senator Everett: In line with what Mr. Gilmour has said, if the Association would like to give further consideration to this, one of the gentlemen here said that he feels it is a loophole that should be closed. The architects, while there may be special interest, have given consideration to the fact and they say that it is part of the means by which we build buildings, and if people wish to defer their tax by this method, and it is nothing more than a deferral, that nevertheless this does have the effect of providing the capital for his type of building.

The Chairman: I understand, though, that what they are asking is that there should be an exception to the prohibition.

Senator Everett: An exception only in respect of buildings in which they actually have an office. I was asking them if they wanted to reconsider whether the prohibition should be effected at all.

Senator Phillips (Rigaud): I would like to know what is the average expense incurred by a successful dentist under the heading of educational expenses, inclusive of conventions and entertainment. Let us say a dentist would earn $25,000 a year. By that I mean net, after paying rental and all that sort of thing. How much money would a dentist spend in a given year for attendance at conventions, entertainment and keeping up to date, and all that sort of things? Would it be 5 per cent, or more, or less?

Dr. McIntosh: I would say $4,000 to $6,000.

Senator Phillips (Rigaud): As much as that?

Dr. McIntosh: Yes.

Senator Phillips (Rigaud): That is to say a dentist earning $25,000 a year would be spending $4,000 to $6,000 a year?

Dr. McIntosh: If he is going to take in two conventions, plus post-graduate training. It costs a lot to travel and stay in hotels these days. You included entertainment expenses.

He may be a member of a club, or do some entertaining of this kind. So I would think $4,000 to $6,000 would not be hard to arrive at.

Senator Phillips (Rigaud): I know the lawyers will be appearing tomorrow and I think there is the same problem of conventions and entertaining expenses. My thinking has been along the lines of a percentage of income to allow for all these expenses, rather than burden an income taxing statute with all these troublesome details. With that background, if there were a percentage of income allowed as an expense under the various headings, that is to say education, conventions, entertainment, and the like, and with your knowledge of the dental profession, do you think that that percentage allowance would be abused in the sense that a number of dentists would be able to get that deduction without actually spending the greater part of the allowance?

Dr. Beach: I think the income tax authorities could pretty well figure that out from the receipts they have for the expenses.

The Chairman: On the figures we have here now, Senator Phillips, on $25,000 income it is pretty close to 20 per cent.

Senator Phillips (Rigaud): Yes, I think that is rather high.

The Chairman: I do not think you could expect the income tax authorities to give even a percentage rate that would be deductible without accounting. In other words, you would have to certify that your expenses were incurred and name the conventions and educational expenses.

Senator Phillips (Rigaud): But not to exceed a certain percentage.

The Chairman: And 20 per cent looks awfully high.

Senator Phillips (Rigaud): I reacted that way by surprise.

Senator Hays: Have you been receiving this amount of allowance?

The Chairman: They have been receiving attendance to conventions.

Senator Hays: But in that amount, $4,000 to $6,000?

Dr. McIntosh: It varies considerably, because one man may attend two conventions in his own city and another may decide that because of his special interests he should go to the international meeting, which perhaps is in Bulgaria, or some other distant place. I have tried to give the maximum figure in response to your question because we do encourage our members to take full advantage of these educational opportunities because they then can serve the public better. What I was trying to indicate was that it would be easy for a dentist, quite legitimately, to spend up to this amount of money in order to take advantage of the various opportunities that are now available to him. Of course, we do now have to justify these expenses.

Senator Phillips (Rigaud): I think there is something to the point that the profession should be encouraged to be in the van of technical knowledge, experience and the like. It would appear to me that we could simplify our tax structure by providing an amount not to exceed a percentage of net income for all professional men, a recognized group of professional men, lawyers, doctors, architects, dentists and so forth, provided, as our chairman said, that it is authenticated.

The Chairman: I think Mr. Gilmour has had a lot of experience with these matters. Maybe he could tell us something about it.

Mr. Gilmour: Senator Phillips, it has been my fortune over the years, both as a tax collector and a tax adviser, to have had many dealings with the medical and, of course, dental professions. Like most of our professions, the operating expenses of a professional man will average about one-third of his gross fees. Mind you, if his gross fees are very low in his early years of practice, then he cannot afford the one-third. For a very successful practitioner, as you very well know from your own professional experience, if he can hold the total operating expenses to one-third he is a pretty successful operator.

Referring to the expenses of conventions, two are allowed to a self-employed practitioner, and a dentist must be self-employed. A single convention, with an air line ticket and so on, can very quickly run up to $2,000 a year, with a weekend in a hotel somewhere at Banff, or some such place, and if there are two it could be a minimum of $4,000.

Then, of course, so much medical work depends on referrals. It is the custom, in one form or another, to pay for those referrals of business. It is done in a variety of perfectly

legitimate ways, so someone can very quickly run into an expense ratio of about one-third. That is quite common in the legal and accounting professions. In practice, the tax assessor takes a look at the ratio. Mind you, that ratio is quite different for a youngster starting out, but with an established man that rule-of-thumb method seems to be followed, and is borne out by actual experience of well-established practitioners. Again, as we discussed this morning, there is really no need suddenly to clamp down on a convention expense, because it is just as much an expense as rent is.

Senator Phillips (Rigaud): I would expect that once the White Paper indicates that there are certain types of expenses which are to be disallowed, we in this committee must look for a formula by way of suggestion to counter that. We are not dealing with normal expenses, such as rent, stenographers, stationery and so on. We are dealing with particular types of expenses that the government feels, rightly or wrongly have been abused. Sooner or later we will have to tidy up the position of architects, lawyers, dentists and all the professional men, and although there are differences, I think to be practical about it we would have to work out some consensus of what we think is right by way of a percentage of the professional man's income under the heading of educational expenses, conventions, entertainment and the like. I was wondering whether you would like to express an opinion on what the percentage should be in respect of a ceiling amount, in any event, as the Chairman said, to be authenticated by voucher.

Mr. Gilmour: I have been doing considerable thinking along these lines. My first reaction, perhaps being stubborn, would be to question whether there is a real abuse with respect to convention and entertainment expenses. I submit that there has not been. However, let us assume that there has been some abuse. I would suggest that the abuse is minimal in its effect on taxes. I think Finance could be asked to indicate what portion of these expenses can be regarded as unreasonably high. They have their statistics to show that. I would submit we will find very little abuse. Therefore, we come back to the question: if entertainment—or business promotion, which is a vulgar phrase—conventions and the like are legitimate business expenses, as I believe they are, I think the amount of tax involved in this is so negligible that really none of us should be wasting time on that little subject.

Senator Phillips (Rigaud): I would still like to pursue it in the sense of being realistic. If this committee turns up with a series of recommendations, which is its duty, I would like to get some guidance from those in the professions on what would be regarded as a reasonable percentage of income that should be allowed for educational and entertainment expenses.

The Chairman: Let me phrase it this way then, if Mr. Gilmour is having some difficulty. He has given us a figure of one-third as being an expense or cost of carrying on business. What part of that one-third based on his experience might be related to conventions and education?

Mr. Gilmour: Somewhere in the vicinity of five per cent of gross fees. I am speaking now from the general experience of my own firm. In the chartered accountants profession education is a very expensive hobby. We spend a lot of money sending boys back to school, back to university, keeping them on the payroll while they are there, or organizing lectures and that kind of thing. For the so-called business promotion expenses, we ourselves would require a partner to be a member of preferably two business clubs. The athletically inclined head for golf clubs; the lazy fellows like myself head for the St. James' or some place where there is a good bar! The total there, I would think, realistically would be about five per cent.

The Chairman: Mr. Gilmour, if we applied this to the figures that Dr. McIntosh gave us, taking a $25,000 net income, excluding conventions and things of that kind, five per cent is only about $1,250. Relating that to what you said about going to Banff for a convention, to attend that one convention might cost more than $1,250. Are not we getting a little low? Would not 10 per cent be a little closer approximation.

Mr. Gilmour: I am speaking of my own firm. I must confess I am speaking of a huge, well-organized firm; some partners spend nothing on business promotion, while others spend probably too much. The overall percentage, including office salaries, should run around one-third. We treat business promotion expenses as strictly personal, and no one partner is asked to bear the personal expenses of another.

The Chairman: You do not have that situation with dentists.

Mr. Gilmour: No. In a large firm it is fairly well established. That brings me back to my original stubborn statement that I would challenge whether there is abuse of convention expenses or business promotion expenses, such as any of these gentlemen belonging to a businessmen's club, the average fee being perhaps $300 to $400 and the average house account per month at the outside may be $50 for a single practitioner, which are not large expenses.

The Chairman: Would you agree that 10 per cent might be a better approximation than your first statement of five per cent?

Mr. Gilmour: Yes. I think I would still like to challenge whether any per cent is needed.

Senator Phillips (Rigaud): Thank you, Mr. Gilmour. I would draw a distinction between educational expenses and entertainement expenses. I think if the recommendation said that we like 10 per cent for education expenses for professional men, and not to exceed three per cent for entertainement and the like, covering clubs and that sort of thing, that might receive a willing ear, because there is a great difference between that and money that could be spent for, say, medical people and professional people generally to keep up to date. Even if there is a general rule, lawyers are brought up to date more easily through books, articles and periodicals whereas as technical work, such as medicine and all the rest of it, calls for conventions, change of view and the like.

We have to think in terms of the general rule, and I would like to read into the record that this committee ought to consider the expenses of professional men. I am expressing a personal opinion, but generally there is something to be said for thinking in terms of 10 per cent for all forms of educational expenses, which covers conventions and the like, and three per cent for entertainment expenses.

Senator Isnor: Why single out the professional?

Senator Phillips (Rigaud): In any event, these percentages should not apply to net professional income in excess of, say, $25,000.

The Chairman: We use the word "professional" because that is the word used in the White Paper. We are dealing with professional expenses in this particular context.

Senator Molson: I do not like the term "entertainment expenses" too much.

The Chairman: I think it is promotional.

Senator Molson: I think it is promotion. I do not really think there is any place in the scheme of things for entertainment expenses under that terminology. Do they use that term?

The Chairman: Yes, it is used in the White Paper.

Senator Molson: Then I think we ought to suggest they take it out.

Senator Phillips (Rigaud): This is what they are attempting, they are attacking:

> ...entertainment expenses, the costs of attending or sending employees to conventions, and the cost of dues for membership in social or recreational clubs.

That is paragraph 5.9 of the White Paper. That is the actual wording.

Senator Molson: I think it is an unhappy phrase, because probably it is right that there should be no entertainment expenses. Business promotion or professional promotion expenses is a very different thing.

Mr. Gilmour: If I could interrupt for one moment, there was a reference earlier to the case of the Royal Trust carried to the Exchequer Court. I happened to take part in that. I believe Jack Pembroke was president and he gave the testimony. In his own very rigid way he testified that he was a member of 30-odd clubs. One of the clubs was Mount Bruno. The crown lawyers listened to Jack's statement that he belonged to various clubs for business purposes and that ordinarily they discussed business. In due course the crown lawyers asked Jack how often he played golf at Mount Bruno. Mr. Pembroke looked around and said, "On Friday afternoons I must confess I phone up a friend and suggest that we sneak off". "Do you always talk business when you are playing golf, Mr. Pembroke?" "Hell, no, I never talk business." They all started to get anxious at that point. Mr. Pembroke turned around to Justice Thorson and said, "By the way, My Lord, I pay for Mount Bruno out of my own pocket". That won the case for us.

The Chairman: Dr. McIntosh, would you care to comment?

Dr. McIntosh: I would like to comment on one of the statements Mr. Gilmour made with respect to the 30 per cent overhead for the professional man. I do not know whether this is important to the hon. senators or not, but our statistics indicate that for the dental profession this is extremely low. Our overheads run from 40 to 60 per cent. I am quite aware that it is very much different between the medical profession and the dental profession, because they have so many of their facilities in the hospitals whereas we do not. Our overhead is generally a good deal higher. For a dentist to have an income of $25,000 his gross has to be in the vicinity of $60,000.

Senator Hollett: No wonder you charge us so much to get a tooth filled.

Mr. O'Brien: I have one comment on promotional expenses. I think you might find in businesses going down or during an inflation period you might be spending more money on promotion in order to bring that business up.

The Chairman: Our approach to it is on a percentage basis. I think we have got to find and hit a percentage that will work fairly, no matter what the conditions are.

Dr. Spence: There is a section on page 5 of the recommendations on capital gains. This does not necessarily mean that the members to this profession in Canada are enamoured about the idea of a capital gains tax. We certainly had a lot of discussion on that this morning. We feel that capital gains derived from the sale of a principal residence should not be taxed. The alternative there should be a complete roll-over if the new residence is purchased within a reasonable time of the sale.

The Chairman: That is the American method.

Dr. Spence: Yes, sir. Dentists who move on a temporary basis to an area outside Canada should be entitled to elect to continue as Canadian residents with a complete roll-over. I believe this refers to Canadians taking courses who may be in the United States for 18, 24 or 30 months. Under the present recommendations of the White Paper, upon leaving the country for this period and having sold their residence they would be subject to tax. In the alternative, a dentist who moves to a new area to establish a practice or to study should be permitted a complete roll-over exception.

The Chairman: You are still talking about principal residence?

Dr. Spence: Yes. With regard to the question on capital gains, the value of goodwill of a dental practice on valuation day should be excluded from tax and only the difference between the amount of proceeds received for good will on the sale and the value on valuation day should be subject to the capital gains' tax.

The Chairman: This is talking about your own?

Dr. Spence: Yes, the sale of a practice. The final recommendation I would like to highlight is the question of investment income of clubs and other non-profit organizations. We feel that the investment income of associations such as the Canadian Dental Assocation should not be subject to corporation tax.

The Chairman: Is this investment income for bursaries, research or what?

Dr. Spence: Perhaps the executive director would like to answer that.

Dr. McIntosh: You have said precisely what a good deal of this income is used for. There is a certain amount that goes into the general operation of the organization which in turn is done to try and promote dental health in Canada so that there is no ulterior motive behind it, other than to use the money to promote the interests of the dental profession and the services that it performs.

The Chairman: You never declare a dividend?

Dr. McIntosh: No sir.

The Chairman: Are there any other questions anyone wishes to ask?

Thank you very much for coming this afternoon.

The Chairman: We have two briefs left. One of them is a very small one. The person who is going to present that brief has been waiting here all day but I think it will only take fifteen or twenty minutes. We can now go ahead with St. John's Cemetery on the Humber. Mr. Dunsford, the president is here and Mr. Martin, the director.

Mr. Dunsford, are you going to make the presentation now?

Mr. M. Dunsford (President of St. John's Cemetery on the Humber): I am going to make the introduction.

Mr. Chairman, honourable senators, Mr. Martin and I are long time members of the St. John's Cemetery on the Humber, which is a non-profit corporation without shared capital. There is no commercial motive present in this activity.

We presume that you are giving us the privilege of appearing here as being representative of the very many small cemeteries scattered across the country which are unable to appear before you. In the first place I should like to thank you, sir, for this opportunity of appearing before this committee and presenting to you our views on the effect which we feel the proposals in section 554 of the White Paper on Taxation would have on St. John's Cemetery on the Humber. I should like to leave this to Mr. Martin, who was responsible for the preparation of our brief.

Before calling upon him I would like to give you, very briefly, some information about the cemetery that I hope will help you to understand our position.

St. John's Cemetery on the Humber is the burial ground of the Denison family of Toronto. It is situated on the east bank of the Humber River in the Borough of York, formerly the township of York, just south of the former town of Weston, about ten miles from downtown Toronto.

The original member of the Denison family to settle in Canada was Captain John Denison who purchased a farm in the township of York on the bank of the Humber River in 1798. In 1801 he lost an infant daughter and, there being no public burial ground at that time, she was buried in a corner of the farm. Subsequently he set apart and fenced four acres of his farm as a burial ground. Later in his will he specifically requested that his heirs continue this. This parcel of land with the addition of the two acres in 1891 became the present cemetery.

In 1853 the cemetery property was conveyed to the Bishop of Toronto to be held in trust to be called St. John's Cemetery on the Humber. In 1868 the cemetery was consecrated by the Bishop of Toronto. The members of the family continued to be responsible for the care and upkeep of the cemetery. Sixty years later, in 1928, the then Bishop of Toronto expressed the desire to be relieved of the trusts concerning the cemetery and a family committee decided to form a corporation. They applied to the provincial secretary for letters patent, which were granted on February 21, 1929. Since that date the administration and maintenance of the cemetery have been carried on by the corporation.

Now, sir, with your permission I should like Mr. Martin to take over from here.

The Chairman: Tell us about the problem, Mr. Martin?

Mr. E. D. K. Martin, Director, St. John's Cemetery on the Humber: The problem is that there are three types of cemeteries that I know of in Canada. There is the oldest type, which are operated by a church or a municipality and are recognized by the income tax administration as charities.

The second type is the commercial cemetery which sell lots and pay tax on their profits, just as any other business. The third type, in which we fall, is just a plain non-profit cemetery, and there it is. We have managed to look after the graves and obtain funds for that purpose. We have managed to accumulate in the Supreme Court of Ontario and with the Royal Trust Company some $40,000, which is not a large capital sum, but the interest on that pays just about all the expenses. At this point Mr. Benson wants half of it. We just do not know how we are going to carry on if half of our gross income is taken from us. This is not a tax on income at all; it is a tax on gross, and it is worse than would be applied to any commercial operation. I did not believe at first that this was intended to apply to something like ourselves which, being consecrated ground, is like a churchyard. I cannot see the difference. I communicated with a senior member of the tax policy division of the Department of Finance and asked if this was to be applied to us. He replied certainly it was. He did not use the term personal living expense, but that is the way he thought, that having these funds in the corporation saves our pockets because if we did not have those funds there we would just have to pay more.

If you have ever tried, and I am sure you all have, to raise money for a worthy cause, there is a great difference between money in your pocket and money in the cause's pocket. This money is set aside to take care of the graves. We think that the proposal in the White Paper, to have half the income, is wrong. It is not a charity, but it is at least, as

Scots I believe call it, a pious benevolence and should be treated as such. Secondly, to apply income tax on gross income is grotesque. Thirdly, there are the inequities that this treatment of cemeteries will create with respect to the churchyard or municipal cemetery, where everything given to it qualifies as a charitable donation and all the income will be exempt. There is also the commercial cemetery, where all the income that is used for paying expenses will be deductible before they pay income tax.

Finally, if those responsible for a burial pay for a plot in any cemetery, that is deductible in computing estate tax. We cannot charge for burials, so anything that comes to us is straight after tax dollars. We think that is bad enough treatment. Accordingly, gentlemen, we would like you, when you consider the position of cemeteries in general and not us particularly as we are not very different from a lot of others, and the history which Mr. Dunsford related to you could be duplicated a hundred times in southern Ontario, the Eastern Townships and the Maritime Provinces, we respectfully urge that the proposal in paragraph 5.54 not be applied to cemeteries or, in the alternative, that non-profit cemeteries where there is no commercial motive should be declared to be charities for the purposes of the Income Tax Act.

The Chairman: Have you explored the possibility of setting up a foundation?

Mr. Martin: In one way, sir. I spoke to the Registrar General of Charitable Organizations last week. He said that the only cemeteries that they will recognize as charities are those operated by either a church, a religious organization, or a municipality.

Senator Desruisseaux: Can you not convince the Bishop of Toronto he had better take it back?

Mr. Martin: We have not thought of that, but we may be driven to it, sir.

The Chairman: Maybe in the whole City of Toronto you could find a minister who would be prepared to take it on the basis that it did not cost him anything.

Mr. Martin: Perhaps I had better get myself ordained.

Senator Burchill: Does the cost of maintenance not come out of the revenue from your foundation?

Mr. Martin: Yes, sir.

Senator Burchill: Does that not take up practically the whole of it?

Mr. Martin: Yes, sir.

Senator Burchill: And yet they want half the gross?

Mr. Martin: Yes, sir, they want the gross without any deductions for our expenses.

Senator Molson: It seems to me that it is a little fuzzy thinking in an instance like this in the White Paper. It is a non-profit organization. Why should any income be taxed at the gross stage? I do not follow any justification for that at all.

Senator Hollett: Neither do I.

Senator Molson: I think I could understand it if it were a sale farther on than that stage and there was a residual profit or surplus in an operation. I think that could very rightly be questioned. Surely with respect to a non-profit organization that spends its money to take care of the graves of the dead, it is carrying it a little far to say we want half the gross income on the investments that provide the main care and maintenance money.

The Chairman: It is going a long distance for a little tax.

Senator Molson: Yes, and the principle seems to me to be causing it.

The Chairman: We will have a look at it.

Senator Phillips (Rigaud): How many organizations of this type did you say exist in Canada?

Mr. Martin: I do not know how many in Canada, senator, but the information that was given to us by the cemeteries branch of the Province of Ontario was that there are over 2,800 in the Province of Ontario alone. I understand the responsible minister is protesting about it because if the care and maintenance of these go downhill then the municipalities will have to look after them.

Senator Molson: How many graves are in the cemetery of St. John's as a matter of interest?

Mr. Martin: I think it is about 200. We do not know the latest figure.

Senator Desruisseaux: Would you add new people now?

Mr. Martin: It is a family cemetery, sir, but I cannot control who my children marry, so that anybody that they marry...

Senator Desruisseaux: Could be buried there when the time comes?

Mr. Martin: It started as a small group. There are now 1,700 scattered from Hawaii to England, from the Northwest Territories to Trinidad. There is every shade of the Christian religion and there are some non-Christians, too.

The Chairman: Honourable senators, the last brief today is from the Canadian Association of University Teachers. We have here Professor Byrd from McGill University and Professor Monahan from the C.A.U.T. Professor Byrd will introduce the discussion.

Senator Beaubien: Would Professor Byrd tell us what department he is from?

Professor K. F. Byrd, Canadian Association of University Teachers: I am professor of accountancy at McGill.

The Chairman: Have you a summary statement you wish to give?

Professor Byrd: Just a few remarks based on what we have already put in. First I would like to emphasize the question of expenses. We have made the point in the brief, and it is the position that we put before the Carter Commission. I feel that a university professor is practising his profession in the only way he can practise it when he is a professor at a university. There are some professors who are professional men from other areas. I myself am a chartered accountant, which would enable me to practise outside the university as a chartered accountant.

A university professor is a professional man who is practising only in employment; he has no alternative opportunity to practise other than as a university professor and carry out his aim of education. It therefore seems to me that this in itself should justify a particular attitude towards him in regard to the question of deduction of expenses. The deduction of expenses is a question constantly brought before the C.A.U.T. by professors, who are having to incur a great deal of expenses in the form I have indicated in the brief.

This afternoon we have heard a great deal about conventions. A university professor is bound to attend conventions. If he is to carry out his task properly, he must attend the Learned Societies meetings, which will be taking place this year in Manitoba. It should not be assumed that the university pays the travelling expenses and costs of attending that convention. Some uninversities do, some do not. Certainly in the case of McGill, for instance, there will be no general agreement that the expenses are paid by the university. Certainly the senior men in the university will probably pay their own expenses.

Le us be quite clear. In the first place, if they are only professors, if they are only in employment, at the present moment they are not allowed to deduct these expenses; they have to incur them. If they are not paid by the university, then the professor himself has to pay them himself.

Senator Everett: What do you mean by "have to incur"?

Professor Byrd: If a university professor wishes to carry out his profession to the best of his ability he must attend the convention of Learned Societies in Manitoba.

Senator Everett: I understand that. It is not a condition of his employment?

Professor Byrd: No, it is not a condition of his employment, certainly not, but I think it is a moral obligation.

Senator Everett: Yes indeed.

Professor Byrd: It has always seemed to me a very great disadvantage that only in a year when I myself am earning income from outside the university can I claim the cost of attending the convention. That is the first point.

To me, then, the university professor is a professional man practising his profession, and I would like him put on that level so that he is able to charge and claim any expenses he can justify, which can be supported by evidence, and which would be claimed by any other professional man.

The Chairman: Which is part of his educational process?

Professor Byrd: Yes. I think it is a moral obligation to attend the meetings of the Learned Societies. I think it is a moral obligation on my part to attend the chartered accountants convention.

Senator Everett: Can you tell me whether a lawyer working for a large corporation, or

alternatively for the Government, is entitled to deduct these expenses?

Professor Byrd: They are not entitled to if they are only in employment. Again, the distinction there is that they have alternative opportunities. They are not in the position of only being in employment; they could practise if they wished. A professor of English, for example, cannot practise outside the university.

I shall refer to matters such as sabbatical leave again in a moment on the second part of the brief, which concerns the question of taxing fellowships and so on. The costs of sabbatical leave are or may be very considerable in certain years. It has always seemed to me that a professor going overseas to do research work, which is closely concerned with his professional teaching, should be entitled to deduct the cost of sabbatical leave, the travelling costs. Quite apart from whether he has any particular fellowship income or grant, if seems to me that if he can show the circumstances to justify it he should be able to deduct these expenses. At the present moment he is, and would be under the White Paper, subject simply to a $150 allowance, which is proposed in the White Paper, or the maximum three per cent. Under the Carter Commission Report it was to be a maximum of $500. We made exactly the same representation there. The principle has been very definitely recognized by the Carter Commission. You must remember that although a maximum of $500 was recommended there, it was a maximum only compared with the percentage. If the individual was able to show particular circumstances and give the evidence of incurring greater expenses, then the Carter Commission recommended deduction. The White Paper does not do this. It therefore seems to me that the White Paper is very far from being generous when making a general deduction of $150, which at the present moment would apply to university professors.

The Chairman: Do you think the professor should be classified as self-employed?

Professor Byrd: That is my main claim, certainly. I think he should be classified as a man practising his profession in self-employment. That is the point I make in the brief. It seems to me that his relation ship to his fellow professors is certainly different from that of employees in an ordinary institution.

The Chairman: Why should they not change the description of how they are remunerated? Instead of calling it salary, why should it not be a retainer?

Professor Byrd: This is a very good point. I may say that this representation has been made to McGill University in regard to the evening employees who are chartered accountants in many cases and who are still classed as employees, whereas they could have easily been allowed to bill the university. It seems to me that this would be a perfectly justifiable thing.

The Chairman: You might have an agreement as an independent contractor.

Professor Byrd: Yes, this would be perfectly justifiable. There is a useful decision in a recent case which rather enlightens us with regard to this situation. The name of the case is *Alexander vs Minister of National Revenue,* and it involved a radiologist employed by a hospital. The question was whether he was going to be classified as an employee in regard to various expenses he had while attending university for the purpose of bettering himself in his profession or whether he was going to be classified as a self-employed radiologist. The judge then made the distinction between a contract of service which is an employment contract and the contract for services which justifies the professional status in practice.

When we talk of expenses it is very easy to think of certain expenses as personal living expenses. When we come to the question of research scholarships I think we have to remember that the definition of personal expenses has to be very carefully made. The White Paper proposes to tax something which has not been done until now. This is a very major change. It proposes to tax research scholarships, bursaries and research grants, et cetera. This is of very great concern indeed to the Canadian Association of University Teachers and to all university professors, because we have constant problems with regard to the question of expenses of our professors who go overseas.

Take the question of research fellowships. They are really made for the purpose of carrying out research and to do what is a main function of any professor. There are two aspects of his work. He is a teacher, a research worker and he is expected to do both of these things. There is a great deal of competition for the purpose of getting grants and scholarships. It seems to me that there is a general assumption for the moment that a

research scholarship is employment income or income which is to be regarded as normal income. This is certainly wrong, because the major object of research fellowship is surely to cover costs which are going to be incurred as a result of the particular type of work undertaken.

The one thing which I think the Association would like me to emphasize is this: they do not, in the first place, emphasize the non-taxibility of the grants, although I have my reservations in regard to that. They do emphasize their fear that this grant will be treated like any other earned income, subject to a relatively small deduction for expenses, whereas in actual fact the grant is one essentially for expenses and therefore you would expect very little to be left over to be taxed.

Mr. Benson said recently he anticipates $5 million income from this particular action and presumably means $5 million over and above the expenses. It seems to me this is an indication that the expenses are going to be regarded as relatively small, whereas I would anticipate the expenses will, in most cases, probably cover the income.

The Chairman: They say that a grant is to be treated as ordinary income in the hands of the person who receives it. Obviously then all of the deductions that are provided in the Income Tax Act you are entitled to take.

Professor Byrd: That is perfectly true. What are the deductions provided in the Income Tax Act? I quote an actual case of a professor who was going overseas. He had to move and pay all the costs of moving as well as the cost of travelling. He took his family with him probably. He had costs of living at the other end. If he sold his house in Canada, then he would not be duplicating, but if he kept his residence here there would be a duplication. In this particular case one lot of residential expenses would be a reasonable charge against the cost of his fellowship.

The Chairman: Except what you could describe as personal expenses, they would not be deductible.

Professor Byrd: I am afraid that these will be called personal expenses. It is a question of classification of personal expenses. We all agree that ordinary living expenses must not be allowed.

Let us take a case of a summer school in Canada. I have a summer school of my own and there are visiting professors who are coming to me. They will certainly keep two residences going during the period of the summer school. They will have to keep their own home in the town from which they come and also have to have their living costs whatever they go. Normally the living costs will not be allowed as a deduction from summer school.

The Chairman: You start off with the premise that to earn the bursary or the grant you must go to a certain place and must do certain things. If you take the overall expenses and arrive at what may be classified as personal expenses and subtract the differences as a properly deductible expense by reason of the terms and conditions of the grant.

Mr. E. J. Monahan, Assistant Executive Secretary, Canadian Association of University Teachers: That is fair enough. Professor's Byrd's concern is that the kind of expenses actually involved in this sort of thing are far different from the ones ordinarily considered as deductible. As long as this is clearly understood, then either you change the regulations about deductible expenses within this category or you treat the research fellow in the same way.

The Chairman: If the qualification for entitlement to a grant has certain conditions, what those conditions cost should be related expensewise to the grant.

Professor Byrd: This is perfectly true.

The Chairman: And if this is not done, this is a point we should consider.

Professor Byrd: I would draw your attention to a case I give you in the brief. This is spelled out. This case also was presented to the royal commission. It was a case where it is quite obvious that costs of transfer from Memorial University to Saskatchewan should clearly have been allowed, but they were not. This is something the income tax authorities in the past have certainly been slow to accept, so we are particularly anxious in the case of fellowships, simply because we anticipate most of the expense incurred will certainly be deductible, and we would anticipate in most case the expenses may very well exceed the amount of the grant.

The Chairman: Maybe we can nudge it up.

Professor Byrd: At the present moment one of my own staff wants to go to Wisconsin to take his doctorate. He must go because there

is no future for him at the present moment. Circumstances have changed very much in the last few years, and there is no future at the university without a doctorate for anyone above the rank of assistant professor. He is going to have to go for at least two and probably three years. This man is being given half salary by the university, but he is now applying for grants and has been granted a grant by the Canada Council. Is such a grant remuneration? Is it income in the ordinary sense, or is it a grant to cover his expense? Certainly, in his case it will be a grant to cover his expenses, and he will not make a profit from it. So, to me, the grant from the Canada Council should not be taxed or, if it is taxed, it should be anticipated there will be very little of it to be taxed in the end after expenses have been deducted.

The Chairman: Maybe part of this could be dealt with, depending on what terms and conditions are written into the grant.

Professor Byrd: This can always be done, of course. The Canada Council grant naturally meets very widely differing circumstances.

The Chairman: It could be specifically stated that it is for the purpose of defraying certain expenses.

Senator Molson: Speaking about moving and going to Europe on research work, and so on, in the universities this happens to an enormous degree, the movement of people.

Professor Byrd: Yes.

Senator Molson: Does this mean that your association is not particularly keen on the taxation of a capital gain on a principal residence, which is one of the things in the White Paper we have been talking about

Professor Byrd: The association has not given thought to that in actual fact. I do not think the question arises, although of course it might. At the present moment the income tax authorities allow you to be regarded as non-resident if you sell or rent your house and leave Canada. You are a non-resident for the time you leave, if you go for six months or a year. Under the White Paper—I am afraid we have not brought this into our brief—it may well be that a tax would have to be taken into account. This might considerably affect the university professor if he intends to return. If it is only a case of being forced to sell in order to get non-resident status and he goes overseas, it seems to me entirely inequitable to tax as if it were for the purpose of an ordinary change of residence.

Senator Molson: This has been raised with regard to people in business.

Professor Byrd: Yes.

Senator Molson: I think it may be a hardship.

Professor Byrd: Yes, particularly in the case of people going overseas possibly for one or two years with the intention of returning.

The next point I would like to make is to emphasize that this question of taxation of fellowships is closely concerned with what I think is important for Canada in regard to the question of attracting people from outside Canada to the United States. If it should turn out that the tax is going to reduce, as I think it will, if the income is taxed then it will reduce the amount received to something far below the level of anything that will satisfy and enable a professor to do the work required by the fellowship. This immediately means that by comparison to the United States and Britain this is going to be most invidious. It will discourage our own professors from going outside Canada. It will close down a great deal of their sources of knowledge.

To my mind it is a very great advantage to Canada to be able to have contacts with the countries outside. The universities would certainly encourage travel by their professors to these other countries. However, the danger is that from our point of view it will close down our opportunities of making contacts with these countries.

This brings me to the next point: when it comes to this question of two years convention by which at the present moment in regard to the United Kingdom and the United States a university professor is able to go to one country for a period of up to two years to teach and is regarded as not taxable in the country to which he is going, it is proposed to remove this convention. The White Paper proposes to remove this and get the conventions changed. It seems to me that we shall not attract people to our country who we ought to wish to attract. Not only are we proposing to make provisions which are going to retain our own professors within this country, but it is cutting off and making less attractive to others outside the country the opportunities to visit Canada. Boh of these, it

seems to me, militate against the progress which is very necessary within our universities. We do not want to be insular. We do want to keep up our contacts. Obviously, if we change our side of the convention, they will change theirs. This means that we are going to break down our conventions with the other nations. The White Paper proposes to tax the amount of any income received, the amount of any investment.

The case I have been making is that of scholarships to non-residents. It is proposed to tax scholarships to non-residents for perhaps 15 per cent to 25 per cent of deduction at source. It seems to me that this action is militating in exactly the same direction. It will prevent the non-resident from coming in if Canadian scholarships are going to be taxed and they know that they are going to pay tax of 15 per cent or 25 per cent. This surely will prevent them coming to us.

The Chairman: There is a further question there. That is really a withholding tax. The question would be whether the person coming here and being subject to that would have any income at home against which he could offset or be allowed a withholding tax, but it seems that in that area you are dealing with small amounts.

Professor Byrd: Yes, but it is still psychological and it will have quite an effect on...

The Chairman: I did not mean it quite in that way. I meant it from the point of view of the Government.

Professor Byrd: Yes. It seems to me to be quite an invidious and unnecessary block to put in the way of attracting the very people we want in this country.

I am going rather hurriedly because I realize time is passing, and I want to cover the whole ground. The next point that I come to is on the matter of pensions. We are very concerned about the position of the T.I.A.A. and the C.R.E.F. In the United States there is a special university professors insurance provision under the Teacher's Insurance and Annuity Association and the College Retirement Equities Fund. These are really the same. They are under the same organization, and they are the institutions set up specifically to provide pensions for university professors.

Until 1960 or thereabouts there was always a strong incentive for Canadian professors to join these funds, particularly the C.R.E.F. I am a very great believer myself in what we call the variable annuity. We are in an age of inflation, as you know. If there is one thing that is most certain it is that time can play havoc with the provisions of a pension scheme that is not specially set up to have regard to the changing cost of living. There has been ever since about 1952 in the United States the facility under the College Retirement Equities Fund by which the university professor in the States was able to put half his funds into equities—into a fund which built up his securities on the basis of investment in equities—and the other half of his funds went through the T.I.A.A. to the fixed interest funds. He knew that by the time he retired he would be able to have within the fund a capital sum which would enable him, partly on a fixed interest basis and partly on a variable income basis, to have a retirement annuity which provided for his old age, and which was automatically geared to the cost of living.

In Canada at this time, in the early sixties, we did not have variable annuities. They are only now being offered by our insurance companies. I have been amazed that Canadian insurance companies have been so slow in offering these because in this age of inflation they are absolutely essential.

In the fifties a very large proportion of the staff of the University of British Columbia had their pension moneys invested in the T.I.A.A. and the C.R.E.F., and I understand from the president of their association that nearly a quarter of the staff still have their pensions invested in this way.

The position under the present Income Tax Act is that since at least the early sixties we have no longer been able to invest our registered retirement savings in other than Canadian institutions simply because the act says that not more than ten per cent of the assets of the registered retirement savings fund must be invested outside the country if it is to be accepted. But there is not at the present moment such a prohibition in the case of pension funds so that still the Canadian Pension funds have been able to be invested in TIAA and CREF, the College Retirement Equities Fund.

Now, the provision is that, if this continues under the White Paper, the White Paper is proposing to remove the deductions, the acceptability not only for registered retirement savings funds but for pension schemes in any funds invested outside the country to more than 50 per cent. Therefore, the White

Paper is apparently going to block the TIAA and the CREF.

The Chairman: The people from the Chamber of Commerce who were here this morning suggested in their brief that there should be an exemption.

Professor Byrd: I think there should be, because at the present moment what is U.B.C. going to do if this does go through? Are they going to be asked to sell their investments in TIAA?

The Chairman: Professor Byrd, we do not know about that, and they have not made any submission to us.

Professor Byrd: You mean U.B.C. have not?

The Chairman: I thought you were talking about the University of British Columbia.

Professor Byrd: U.B.C. is one case in point, yes. We are in a way acting for the University of British Columbia. TIAA is something we know very well and so is CREF. I could take my own position. In the 1960s I very nearly did invest. You see, we have this registered retirement savings provision which now allows us to invest up to $1,500 so that we are able to supplement our university pension provision each year to bring it up to $1,500. I nearly did invest the extra each year in the CREF, but at that time I decided not to simply because of the 50 per cent limit. You were only able to invest outside Canada 50 per cent in equities. The other 50 per cent had to go into fixed interest securities, and since we require all the pension funds on fixed interest rates, I was anxious not to put any more in fixed interest, if I could; therefore I used mutual funds in Canada. But it does seem to me that the point I would like to make is that a university professor at U.B.C., who did invest outside Canada, is doing nothing unpatriotic there. It was a very wise thing to do and in doing this, therefore, it seems to me we should not now put any penalty in their way.

I will leave it at that so far as that is concerned. But I should like to make one further point. The White Paper proposes or Mr. Benson says quite casually that he thinks the fact that pension trusts in general will be exempt on investment income and on capital gains is enough and therefore they should not have the benefit that, for instance, any other institutions should have of the 50 per cent tax credit which will be passed on. So he does not propose to pass on the 50 per cent tax credit to any pension trust. To me this is a matter of very real concern. I cannot see the necessity for that. I cannot see that there is any difference between the pension trust and the other institutions. I do not think it is getting that benefit, that tremendous benefit through not being taxed at the present time but through postponing the tax, remember, until the day of retirement of the professor.

I cannot see that this benefit is something that should mean that the pension trust properly should be deprived of the benefit of the integration, which is a fundamental scheme of the White Paper. I wholly and wholeheartedly uphold integration. Integration is something which I think is very necessary for the pension trusts themselves.

The Chairman: Would you agree that instead of refusing the tax credit to the pension fund at the time they receive the income, because they receive it without tax, the credit should be deferred to be applied when the pay-out becomes taxable?

Professor Byrd: That would be rather difficult. If it could be done in principle, that would be all right. But surely administratively it would be better to give the credit at the time.

The Chairman: Administratively.

Professor Byrd: That is what Mr. Benson makes a lot of, the administrative difficulties, which he thinks are inequitable. In this case he things it would be administratively easier to do by just not making the distinction. Why make the distinction between a pension trust and others?

The Chairman: Is it not to give a tax credit where no tax has been paid?

Professor Byrd: No, it has been paid. This is the point I am making. The tax has been paid by the corporation.

The Chairman: If we accept the Chamber of Commerce view as expressed this morning, the answer is that it would be less tax.

Professor Byrd: Certainly part of it would be. If you think the corporation portion is part and parcel of the tax, this is probably quite so but certainly a portion of that has actually been paid by the corporation or by the recipient through the corporation and therefore I think the credit itself is justifiable for passing on to the trust.

Now another point that Mr. Benson refers to—and you must remember that he concedes voluntarily that he thinks there is some inequity in fixing the pension or basing the maximum pension on an annual contribution rather than on the end result, the benefit to be received at the end, and he does concede that he thinks putting an annual figure on it which at the present time is $1,500, which is the maximum figure that can be contributed any year, is not fair. Now this leads me to emphasize first that the $1,500 is inconceivable to me—it is inconceivable that in this age of inflation we are still putting a maximum of $1,500 on the annual pension contribution which was what was on it in 1949. Now why not use the ordinary index, the cost of living index, and apply it to the $1,500 and at least convert it to the equivalent at the present time?

Senator Molson: What would that bring it to?

Professor Byrd: At the present moment, it would bring it to at least, I would say, $2,500 which would be 160 or 170 per cent compared with 1949.

The Chairman: Of course another way of doing it would be to say that the $1,500 was related to a certain average tax rate at that time and then increase the $1,500 by the percentage increase in taxes.

Professor Byrd: That is very difficult. Surely the logical thing to say is that the $1,500 was the reasonable figure at the time and then find the comparable figure. Even as an accountant, I have a great belief and have been arguing for 20 years that the accounting industry should have been using the indices in publishing figures in accounting.

The Chairman: But if the tax rate goes up, then the deductions should go up.

Professor Byrd: But it doesn't.

The Chairman: Personal rates are up since that $1,500 was put in.

Professor Byrd: I understand the point you have in mind, and I made the point in the brief that when inflation causes your income to go up to compensate for the inflation, you gradually rise into the next tax level, so that you are actually paying a higher rate of tax than you paid previously on what is virtually the same income.

Senator Molson: There is no doubt about it, you cannot beat it. I think the figure you give of $2,500 is quite modest.

Professor Byrd: It is the minimum figure.

The Chairman: You are in fact talking about twice $2,500.

Professor Byrd: Well, you see it would be twice $2,500 in effect. That is for an individual. But I personally think Mr. Benson is right in saying that the proper thing, and in our brief you will notice that I mention that at the Royal Commission we mentioned and accepted the Royal Commission's statement that the proper thing, was not to fix the annual contribution or to maximize the annual contribution but to make sure that everybody has the right of building up a certain maximum benefit. This would mean that in the days when a young fellow is not able to contribute because he has no surplus funds to contribute to the pension he would be able to make up the corresponding sum at a later time when he has the funds so as to ensure that when he retires he has a certain retiring figure.

This is obviously the logical thing. Mr. Benson agrees with it. He says that the present time is not the time at which to implement it, so he leaves it. All I say is that I think the $1,500 is ridiculous, because I can see no reason why that should not be changed. We suggested in our brief to the Royal Commission that for a maximum annuity for a retired person, taking into account inflation, $20,000 per annum might be the figure. This seems to me a reasonable one.

The Chairman: And whatever the cost of that is expressed annually it should be deductible.

Professor Byrd: It would certainly be deductible, yes.

Senator Phillips (Rigaud): You have made two points, one on the status of university teachers and the other on pension matters, which you dealt with at great length, and for which we are very grateful to you. I want to deal with the first point. If university teachers were specifically stated not to be employees

but were to be regarded as professional people, would that solve a good bit of the problem? You seem to be reconciled to the fact that the amount of a fellowship, scholarship, bursary and research grant should go into taxable income, or will do, because that is the current fashion. Assuming you are reconciled to that—because we are not living in a climate of great culture where we can sell the idea that university professors must be treated in a special way in respect of certain types of income, although I personally think they should be because of the high quality of their contribution to the life of the country; but that is en passant, and the climate in our country does not allow for that sort of thinking—on the assumption that the item to which I have referred will form part of taxable income, would your basic problem be solved it if were part of the statute that university teachers be regarded as professional men and not employees?

Professor Byrd: Yes, undoubtedly.

Senator Phillips (Rigaud): You would allow yourselves to be classified for treatment with lawyers, doctors, dentists, architects and the like?

Professor Byrd: That is right.

Senator Phillips (Rigaud): In relationship to the types of expenses that should properly be allowed to you?

Professor Byrd: Very definitely. This is my main contention.

Senator Phillips (Rigaud): That is what I wanted to be sure of.

The Chairman: They would have to be careful that they did not hire themselves out on a salary basis. It should be done on a fee basis.

Senator Phillips (Rigaud): The word "retainer" was used previously rather than salary. I am trying to capture the main point.

The Chairman: That is the main point.

Professor Byrd: This is exactly it.

Mr. Monahan: If I might interject, I should like to emphasize that the association is concerned with this anomaly, as most of our members practice a profession but receive a salary, and for income tax purposes are put in that classification.

Senator Phillips (Rigaud): Notwithstanding their quality, learning or anything of that sort?

Mr. Monahan: That is right. Because they are in that classification certain kinds of legitimate expenses are not claimable, which would be claimable were they in the other category.

Senator Phillips (Rigaud): That is my point.

Mr. Monahan: We are not at all interested in special pleading.

Senator Phillips (Rigaud): Following what the Chairman has said, it would appear that this is a great part of the problem for a very important segment of our cultural and intellectual life, and I think it is vital that this matter be cleared up. I was wondering if you were ready to join the professional classes, where at least you would have some advancement.

The Chairman: The question might be where this could best be done. The university charter might be amended. Is that a provincial or federal matter? I think we have been assuming that the place to put it would be in the Income Tax Act itself. I am just wondering whether it should not be established in the place where the professional status is obtained or granted.

Senator Phillips (Rigaud): Except it would be much simpler if you do it in one statute rather than getting all of the universities and schools of learning across the country.

The Chairman: That is right.

Senator Lang: This year the executive of the teaching staff of the University of Toronto wanted to deal with the administration in connection with salary increases, on a collective bargaining basis. How might those who advocate such an approach view the present proposals made by the witness.

Mr. Monahan: On that particular point, with respect, the salary committee of the teaching staff made that proposal but in the following general meeting of the association

that proposal was repudiated and the salary committee resigned.

Senator Lang: Yes, but only by a very narrow margin.

The Chairman: Are there any other questions? I thank Professor Byrd and Mr. Monahan for the presentation they have made and the information they have given.

The committee adjourned.

APPENDIX "A"

MAPLE LEAF GARDENS, LIMITED

SUBMISSION ON THE GOVERNMENT'S PROPOSALS FOR TAX REFORM

MAPLE LEAF GARDENS LIMITED
60 CARLTON STREET, TORONTO, ONTARIO • (416) 368-1641

March 12, 1970

Senator Salter A. Hayden,
Chairman,
Senate Committee on Banking,
Trade and Commerce,
Parliament Buildings,
Ottawa, Ontario.

Dear Senator Hayden:

The purpose of this submission is to express the views of Maple Leaf Gardens, Limited on the White Paper on Tax Reform tabled by the Honourable Edgar J. Benson, Minister of Finance, in the House of Commons on November 7th, 1969.

I would like to say at the outset that we appreciate and are in sympathy with Mr. Benson's objectives of redistributing the tax burden and achieving tax equity for all Canadians to the highest degree possible.

We do not doubt Mr. Benson's or the government's sincerity of purpose and commend those concerned for taking the White Paper approach rather than fait accompli legislation.

It is the intention in our submission to comment mainly on those aspects of the White Paper which directly affect Maple Leaf Gardens. However, because of the impending critical impact on individuals and the whole social system we are also taking the opportunity of making a few comments of a more general nature.

Maple Leaf Gardens, Limited is a public company incorporated under the laws of the Province of Ontario on February 24th, 1931. The company owns and operates the Toronto Maple Leaf hockey franchise in the

HOME OF THE TORONTO MAPLE LEAF HOCKEY CLUB

National Hockey League, the Tulsa Hockey Club in the Central Hockey League and the Marlboro Hockey Club in the Ontario Hockey Association Junior "A" League.

Besides catering to professional and amateur hockey, the arena accommodates track meets, circuses, operas, ballets, concerts and other cultural attractions.

Our conclusions and recommendations are set out in the following chapters:

1. Effect on Maple Leaf Gardens, Limited

Maple Leaf Gardens, Limited paid approximately $1,700,000 in taxes during its most recent fiscal year. These are summarized as follows:

Federal Income Tax	$ 830,000
Provincial Income Tax	250,000
Realty Tax	165,000
Business Tax	40,000
Sales Tax on Admission	415,000
	$1,700,000

Besides, the $1,700,000 in taxes mentioned above, Maple Leaf Gardens, Limited paid gross salaries of $2,170,000 in 1969 from which $502,000 was deducted in the form of income tax and remitted to the federal government.

The gross revenue of Maple Leaf Gardens, Limited for its 1969 fiscal year was $6,062,000. Of this amount approximately $4,437,000 represents revenue from gate receipts and concessions. Approximately 55% of our subscribers are corporations and we estimate that this proportion holds true for most attractions. It has already been indicated to us that many of these subscribers will discontinue if the White Paper proposals re so called entertainment expenses are implemented.

The following is a statistical summary setting out the potential loss of revenue based on the fiscal year 1969:

Revenue from Gate Receipts, Concessions, etc.	% of Revenue from corporations	Revenue loss
$4,437,000	55%	$2,440,000

The following summary compares actual operating results for 1969 with the results that could occur if the White Paper proposals are implemented.

	Actual Results	Potential Results
Gross revenue (including interest income)	$6,116,000	$3,676,000
Operating Expenses (almost 100% fixed)	4,104,000	4,104,000
Operating profit (loss) before income taxes	2,012,000	(428,000)
Provision for income taxes	1,065,000	
	947,000	(428,000)
Extraordinary credit	76,000	76,000
Net profit (loss) for the year	$1,023,000	$ (352,000)

It is clear that the White Paper proposals could result in an operating loss of $428,000 in future years. The loss in tax revenue to the various authorities is also quite clear and can be summarized as follows:

Federal income tax loss	$830,000
Provincial income tax loss	250,000
Sales tax loss - 10% of $2,440,000	244,000

Apart from the revenue loss to the Federal and Provincial Governments it is obvious that the company itself would be in serious financial difficulty with a very real possibility of ultimate failure. In the event of the above circumstances either N.H.L. hockey and, to a very large degree, organized amateur hockey as well, would disappear from Canada.

The disappearance from the Canadian scene of the Toronto Maple Leafs and the Montreal Canadiens, who would be in the same position, is unthinkable. As stated, the effect on hockey in Canada would be disastrous. Hockey is not only Canada's national sport, it is a way of life of countless citizens, young and old, and beyond doubt, contributes in a multitude of ways to the building of young men, to the social structure and to the basic fibre of our people.

It is our opinion that Maple Leaf Gardens, Limited and the Canadian Arena Company (Montreal Canadiens) would be better able than most sports enterprises to stay out of bankruptcy in the event of White Paper implementation. We can only conclude that the sports industry, as a whole, would suffer at least to the same degree and probably even more so.

On balance it would seem to be questionable whether equity would really be served if hockey, in particular, and the sports industry, in general, were destroyed.

2. Entertainment Expenses

We share the opinion of many businessmen that the term entertainment expenses is a misnomer and that the term business promotion expenses is more appropriate. We firmly support the view that expenses for one's own entertainment, including golf clubs, yachts, etc., should not be allowed as a corporate expense.

i) Business promotion is a legitimate corporate expense for income tax purposes

We feel that bona fide selling or promotional expenses, including the use of tickets to sporting events, theatres, restaurants, etc., are a legitimate corporate expense and should be treated as such. Such expenses are a very economical use of executive time, whereby an executive can be with his customers, employees, his business associates, for periods other than the short 9:00 A.M.

to 5:00 P.M. situation. It is accepted practice that business is promoted in other than normal business hours and in other than normal business environment. The cost of such business promotion is a legitimate corporate expense. The cost of creating goodwill among employees should be included in the same category.

ii) Present legislation adequate

The present legislation included in the Income Tax Act and the assessing practice carried out by the Income Tax Assessors in the field ensure that material abuses of business promotion expenses are detected and taxed. The existing legislation is comparable to that in the United States. We feel it is essential that our tax laws not differ materially from those of our southern neighbours as Canadian industry must compete with them not only for the sales dollar, but also in their search for executives and other personnel. Canadian business must be allowed to compete on much the same terms as its American counterpart. As Americans use pre-tax dollars for business promotion, so should Canadians.

iii) Revenue to Government

The White Paper states that it is expected to save $5,000,000 in revenue per annum by reason of the disallowance of entertainment and other expenses. We have outlined in Chapter 1 the potential revenue loss to the various governments from Maple Leaf Gardens, Limited alone. The effects on other areas of the entertainment field will be more drastic than the effects on Maple Leaf Gardens, Limited. Most companies in this field are small operations with fewer employees (many of whom earn the minimum wage and are unemployable in other fields) which could be forced out of business. Many people could be put out of work, which will not only reduce the government's tax revenue from the personal sector, but could cause increased social problems among the unemployed.

We feel the government's view is too narrow and could very easily result in a loss of revenue rather than a gain.

3. Capital Gains Tax

In the interest of income tax equity it may be that a capital gains tax be implemented at this time even though it will inhibit economic growth. Such a tax is in keeping with the taxation philosophies of Great Britain and the United States. In addition, such a tax provides a clear definition of what a capital gain is.

We feel the proposed capital gains tax in some aspects is too radical and punitive. The problems involved in valuing closely held corporations, houses, cottages, art, etc., outweigh the advantage of any increased tax revenues. The taxing of unrealized capital gains in securities of widely held corporations every five years unduly complicates the issue and forces investors to sell securities in order to pay the taxes.

We conclude that a capital gains tax is equitable, but feel it should be restricted to realized gains on land and security transactions.

4. Income Tax

We believe that most Canadians will pay a premium to live in Canada and, in fact, are already doing so. However, it is unrealistic to think that up and coming young men in sports, business, or whatever, will not be influenced by the U.S. market and will be content with too significant a differential in their standard of living. It would be a mistake to give our potential leaders too great an incentive to leave the country.

In conclusion I would like to say that we are aware of the great difficulty facing all concerned with this critical problem. We most earnestly believe that the White Paper should be modified and hope that our

comments will be helpful. Our main concern is that Canada will remain a vital country, full of incentive and opportunity for all and that it does not degenerate into just another colourless, static, socialistic state.

Yours very truly,

George E. Mara,
President.

GEM/lr

APPENDIX "B"

NAME: MAPLE LEAF GARDENS LIMITED

SUBJECT: Business Promotion Expenses

Analysis of Appendix "A" By Senior Advisor

This brief is submitted by Maple Leaf Gardens Limited. This is a public company incorporated in 1931, that owns and operates the Toronto Maple Leaf hockey franchise in the National Hockey League, the Tulsa Hockey Club in the Central Hockey League, and the Marlboro Hockey Club in the Ontario Hockey Association Junior "A" League. The company's arena also accommodates track meets, circuses, operas, ballets, concerts and other cultural attractions.

The brief deals primarily with the effect of the White Paper proposals to deny the deduction of any business promotion expenses upon the operations of this company.

The brief also refers in very general fashion to:

(1) Capital Gains Tax, and

(2) The effect of high Canadian taxes on Canadians.

Members of the Committee will be interested in the following conclusions expressed by the authors of the brief:

(1) " Apart from the revenue loss to the federal and provincial governments, it is obvious that the company itself would be in serious financial difficulty with a very real possibility of ultimate failure. In the event of the above circumstances either N.H.L. hockey and, to a very large degree, organized amateur hockey as well, would disappear from Canada."

(2) " The disappearance from the Canadian scene of the Toronto Maple Leafs and the Montreal Canadiens, who would be in the same position, is unthinkable. As stated, the effect on hockey in Canada would be disastrous. Hockey is not only Canada's national sport, it is a way of life of countless citizens, young and old, and beyond doubt, contributes in a multitude of ways to the building of young men, to the social structure and to the basic fibre of our people."

(3) " It is our opinion that Maple Leaf Gardens, Limited and the Canadian Arena Company (Montreal Canadiens) would be better able than most sports enterprises to stay out of bankruptcy in the event of White Paper implementation. We can only conclude that the sports industry, as a whole, would suffer at least to the same degree and probably even more so."

The is attached the usual summary of present tax laws, White Paper proposals and principal points of the brief.

Name : MAPLE LEAF GARDENS LIMITED

Date Brief Received:

Principal Subject: Business Promotion Expenses

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The Income Tax Act and existing assessing practices recognize that reasonable amounts of business promotion expenses are proper deductions in computing income that is subject to tax. Section 12-2 of the Income Tax Act authorizes the tax collector to refuse to recognize unreasonable large sums expended for this or any other purpose.	5.9 Although the government believes that provision should be made for the deduction of legitimate business expenses that have not previously been deductible, it also believes that the present system permits deduction of certain types of expenses which taxpayers should be expected to meet out of tax-paid income. Consequently it is proposed that the Income Tax Act specifically deny deduction for entertainment expenses, the costs of attending or sending employees to conventions, and the cost of dues for membership in social or recreational clubs. This provision would not prohibit the expenditure of funds for these purposes, but it would ensure that taxpayers who wish to make such expenditures would do so out of after-tax dollars. 5.10 Under the system outlined in Chapter 4, whereby shareholders are given credit for the tax paid by their corporations, merely denying a deduction for this type of expenditure is not sufficient. Although the denial of the deduction would mean that the corporation pays extra tax, the shareholders of the corporation would receive credit for the extra tax paid. Therefore, it is necessary to provide further that, in the case of corporate taxpayers, taxes due because of the non-deductibility of these expenditures would not be creditable.	Page 4, paragraph 2 of Brief This portion of the brief expresses the view that: (1) Business promotion expenses are legitimate business expenses. (2) Existing legislation is adequate to control material abuses of business promotion expenses.

Name : MAPLE LEAF GARDENS LIMITED

Date Brief Received:

Principal Subject: The Capital Gains Tax

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		Page 6, paragraph 3 of Brief This portion of the brief recommends that a capital gains tax be restricted to realized gains on land and security transactions.

Name : MAPLE LEAF GARDENS LIMITED

Date Brief Received:

Principal Subject: Income Taxes Generally

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		Page 6, paragraph 4 of Brief This portion of the brief points out that the increasing burden of Canadian taxation will influence migration to the United States.

APPENDIX "C"

SUBMISSION TO:

The Standing Senate Committee on
Banking, Trade & Commerce,
House of Commons,
OTTAWA,

RE: PROPOSALS FOR TAX REFORM

PRESENTED BY CANADIAN ARENA COMPANY

The Canadian Arena Company was incorporated in 1924 and is a public company listed on the Montreal Stock Exchange. Fifty seven per cent of the 1,025,000 issued shares are owned equally by John David Molson, William Molson and Peter Molson. The balance of the shares are owned by various arm's length corporate and individual investors.

The Canadian Arena Company owns and operates the Montreal Forum and (through its wholly owned subsidiary Le Club de Hockey Canadien Inc.) the Montreal Canadien hockey club franchise. In addition, the Canadian Arena Company owns and operates minor league hockey clubs and carries on other forms of entertainment, all of which are based in the Montreal Forum.

The purpose of this brief is to bring to the attention of the Committee the fact that two of the proposals for tax reform will have a serious and detrimental affect on the Canadian Arena Company and its controlling shareholders. The two offensive proposals are:

1. denial of all entertainment expenses as a deduction in computing income (White Paper - paragraph 5.9); and

2. the five year or quinquennial revaluation of shares of widely-held Canadian corporations and the inclusion in income of the gain (or loss) since Valuation Day or the last quinquennial revaluation (White Paper - paragraphs 3.36, 3.37 and 3.38).

I

ENTERTAINMENT EXPENSES

The Canadian Arena Company rejects the proposal to disallow all entertainment expenses in computing income.

It is clear to the directors and management of the Canadian Arena Company that a substantial number of tickets to National League hockey games are purchased by businesses of all types to be used to generate goodwill. Equally clearly, this is a long standing business practice in Canada and similar practices are recognised and accepted in other jurisdictions such as the United States, Australia, Japan, etc. In addition, the practice has been recognised and accepted by the courts in Canada, the United Kingdom, the United States, etc.

The Canadian Arena Company submits that if businesses are not allowed to deduct the cost of National Hockey League tickets used to generate goodwill there will be a lesser number of subscribers to seasons tickets. It is impossible to judge precisely the decrease in ticket sales, but the directors and management of the Canadian Arena Company expect that the decrease will be between ten and twenty five per cent of total sales, and possibly much greater.

The estimated net worth of the assets owned directly and indirectly by the Canadian Arena Company (apart from goodwill) and the estimated value of the company are as follows:

Capital assets, land, building, fixtures, etc.	$15,000,000
NHL franchise	15,000,000
Total value (estimated)	$30,000,000

Based on normal business practice the return on an investment valued at $30,000,000 should be at least $2,500,000 per annum before income tax, which would mean a return of approximately eight per cent. The actual and estimated return on the investment and business for 1969 and 1970 is as follows:

	Actual 1969	Estimated 1970
Profit before taxes	$2,041,000	$1,726,000
Income tax	1,102,000	941,000
Net profit	$ 939,000	$ 795,000
Per cent return before income tax	6.8	5.79
Per cent return after income tax	3.13	2.65

The forecasted return, based on the 1970 estimates, assuming a ten to twenty five per cent decrease in NHL ticket sales, is as follows:

	10%	15%	20%	25%
Profit before taxes	$1,386,000	$1,211,000	$1,036,000	$ 861,000
Income tax	748,000	654,000	559,000	464,000
Net profit	$ 638,000	$ 557,000	$ 477,000	$ 397,000
Per cent return before income tax	4.62	4.036	3.45	2.87
Per cent return after income tax	2.126	1.856	1.59	1.323

The directors of the Canadian Arena Company have, in the last ten years, followed a policy of paying relatively modest dividends to the shareholders in order that the company could accumulate earnings for re-investment in capital assets of the business.

In particular, in 1968 the Canadian Arena Company was able to rebuild the Montreal Forum at a total cost of $9,800,000 without Government subsidization of any sort. This rebuilding project marked the first time since the construction of Maple Leaf Gardens in 1931 that funds from other than Government sources have been invested in a centre for major athletic and entertainment events in Canada. In other cases of comparable construction, such as in Winnipeg,

Ottawa, Vancouver and Quebec City, the necessary capital for construction was supplied, directly or indirectly, by various levels of Government.

The taxes paid by the Canadian Arena Company and its subsidiaries during its 1969 fiscal year to all taxing authorities were:

Municipal amusement tax	$ 585,463
Municipal, school & water taxes, etc.	602,500
Federal & Provincial income taxes	1,102,000
TOTAL	$ 2,289,963

In addition, the taxes withheld and remitted to the Federal and Provincial taxation authorities by the Canadian Arena Company and its wholly owned subsidiaries on account of their employees (including hockey players) were in 1969:

Federal income tax -	$ 324,782.73
Provincial income tax -	288,641.72

On the basis of the facts set forth above, the Canadian Arena Company submits that the result of the proposal to disallow all entertainment expenses will be to curtail ticket sales to NHL games and that the company will suffer a substantial decrease in revenue. The direct effects of such a decrease in revenue will be:

1. the net profit of the company will decrease sharply reducing the rate of return on the investment below an acceptable level;

2. there will be a net loss in direct tax revenue to all taxing jurisdictions; and

3. the Montreal Canadian hockey franchise will become vulnerable to acquisition by United States interests.

The indirect effects are impossible to forecast but would probably include a deterioration in the operations of the Forum generally and the inevitable acquisition by United States interests of the Montreal franchise. For example, the recent sale of the Vancouver franchise clearly illustrates that no Canadian investors were willing to undertake a venture of this nature. As a result United States interests have acquired control of the Vancouver franchise.

II

THE FIVE YEAR QUINQUENNIAL REVALUATION

The controlling shareholders of the Canadian Arena Company (Messrs. John David, William and Peter Molson) as well as the Canadian Arena Company oppose the proposal that shares of widely-held Canadian corporations be quinquennially revalued and the gain (or loss) since Valuation Day be brought into income. This proposal is unsatisfactory because it will inevitably result in the controlling shareholders losing effective control of the Canadian Arena Company.

At present the three controlling shareholders own fifty seven per cent of the 1,025,000 issued common shares of the Canadian Arena Company. The balance are owned by individual and corporate investors. The market price of the shares at present is eleven dollars and fifty cents ($11.50) and, during the last six months, has reached a high of eighteen dollars ($18) and a low of ten dollars and fifty cents ($10.50).

The proposal contained in the White Paper requires that shareholders of widely-held Canadian corporations take into income a deemed capital gain (or loss) in the year (after implementation) in which the shareholder attains an age divisible by five.

Assuming that the market value of the shares of the Canadian Arena Company increase and that in 1976 the controlling shareholders reach an age divisible by five, each will be required to include in income the difference between the market value of his shares on Valuation Day and the market value as of the end of the month in which he reaches an age divisible by five. Assuming employment and other income sufficient to place the shareholders in the fifty per cent (50%) tax bracket, the deemed capital gain of each of the three controlling shareholders will be subject to tax at that rate. (It should be noted that the maximum personal marginal rate of approximately fifty per cent (50%) will not be reached until the fifth year of the new system and, as a result, each of the three controlling shareholders will, depending upon when they reach an age divisible by five, be subject to marginal rates up to a possible maximum of 81.92 per cent).

However, assuming optimistically that the maximum marginal rate will be about fifty per cent (50%), then in 1976 the three controlling shareholders will be subject to a tax of at least fifty per cent (50%) of one quarter of the deemed capital gain. If there is a modest increase in the value of the shares (from twelve dollars ($12) to twenty dollars ($20))it would be reasonable to estimate the amount subject to tax at approximately eight million dollars ($8,000,000) and the tax at approximately two million dollars ($2,000,000).

Due to the "deemed" nature of the tax, the three controlling shareholders would not in fact have realized any gain and it is again reasonable to assume that, in order to pay the tax of two million dollars ($2,000,000)it is obvious they would have to sell approximately one hundred thousand (100,000) shares in 1976 which would reduce their voting control from fifty seven per cent (57%) to something less than fifty per cent (50%). The problem of marketing such a block of shares would also be substantial and would, by creating an artificial price decrease, unfairly affect other shareholders and new investors.

III

CONCLUSION

For these reasons the Canadian Arena Company and its three controlling shareholders respectfully submit that this Committee recommend to the Government that it should not implement the proposals contained in the White Paper respecting:

1. the disallowance of all entertainment expenses in computing business income; and

2. the quinquennial revaluation of shares of widely-held Canadian corporations.

ALL OF WHICH IS RESPECTFULLY SUBMITTED.

DATED at MONTREAL this third day of April 1970.

CANADIAN ARENA COMPANY

Per:________________
John David Molson

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John David Molson

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William Molson

____
Peter Molson

APPENDIX "D"

NAME: CANADIAN ARENA COMPANY

SUBJECT: Business Promotion Expenses and Five-Year Revaluation

Analysis of Appendix "C" by Senior Advisor

This brief is submitted by Canadian Arena Company. The Company was incorporated in 1924 and is a public company whose shares are listed on the Montreal Stock Exchange. More than 50% of the issued capital stock is owned by three members of the Molson family.

The Company owns and operates the Montreal Forum and several professional hockey clubs.

The brief deals with two aspects of the White Paper:

(1) The denial of all entertainment expenses as a deduction in computing income; and

(2) The five-year revaluation of shares of widely-held Canadian corporations.

Members of the Committee will be interested in the following conclusions expressed by the authors of the brief.

In speaking of the proposal not to allow business promotion expenses:

"The direct effects of such a decrease in revenue will be:

1. The net profit on the company will decrease sharply reducing the rate of return on the investment below an acceptable level.
2. There will be a net loss in direct tax revenue to all taxing jurisdictions.

3. The Montreal Canadian hockey franchise will become vulnerable to acquisition by United States interests." (Pages 6 and 7 of the Brief)

In speaking of the five-year revaluation and imposition of tax on the deemed capital gain:

"Due to the 'deemed' nature of the tax, the three controlling shareholders would not in fact have realized any gain and it is again reasonable to assume that, in order to pay the tax of two million dollars ($2,000,000) it is obvious they would have to sell approximately one hundred thousand (100,000) shares in 1976 which would reduce their voting control from 57% to something less than 50%. The problem of marketing such a block of shares would also be substantial and would, by creating an artificial price decrease, unfairly affect other shareholders and new investors."

The brief submits that the White Paper proposals to:

(1) Disallow entertainment expenses in computing business income; and

(2) Require a quinquennial revaluation of shares of widely-held Canadian corporations

should not be implemented.

The usual summary of present tax laws, White Paper proposals and principal points of the brief is attached.

Name: CANADIAN ARENA COMPANY

Date Brief Received:

Principal Subject: Business Promotion Expenses

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The Income Tax Act and existing assessing practices recognize that reasonable amounts of business promotion expenses are proper deductions in computing income that is subject to tax. Section 12-2 of the Income Tax Act authorizes the tax collector to refuse to recognize unreasonable amounts expended for this or any other purpose.	5.9 Although the government believes that provision should be made for the deduction of legitimate business expenses that have not previously been deductible, it also believes that the present system permits deduction of certain types of expenses which taxpayers should be expected to meet out of tax-paid income. Consequently it is proposed that the Income Tax Act specifically deny deduction for entertainment expenses, the costs of attending or sending employees to conventions, and the cost of dues for membership in social or recreational clubs. This provision would not prohibit the expenditure of funds for these purposes, but it would ensure that taxpayers who wish to make such expenditures would do so out of after-tax dollars.	Pages 1 to 7 of the Brief This portion of the brief expresses the view that the effects of the proposal to disallow business promotion expenses would be: (1) To reduce the net profits of the company and sharply reduce the rate of return on the investment below an acceptable value. (2) To reduce the direct tax revenue to all taxing jurisdictions. (3) To make the Canadian Hockey franchise vulnerable to acquisition by United States interests.

Name: CANADIAN ARENA COMPANY

Date Brief Received:

Principal Subject: Capital Gains - Five-Year Revaluation

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act does not tax capital gains.	3.33 Taxpayers other than widely-held Canadian corporations would include only one-half of their gains on the sale of these shares in taxable income and deduct only one-half of their losses. However, they would be required to revalue these shares to market value every five years and take one-half of the resulting gain or loss into account for tax purposes in that year. A special rate is proposed for widely-held Canadian corporations to avoid double tax. This is explained in Chapter 4. 3.36 The proposal that the accrued gains or losses on those shares be taken into account every five years is one of two exceptions to the general rule that capital gains and losses would be taxable only when they are realized. (The other exception concerns taxpayers who leave Canada.) Periodic revaluation would reduce somewhat the value of the half-gains rule. It would reflect the fact that these shares are readily marketable and that a taxpayer can, therefore, realize his gain or loss fairly easily at the time of his choosing. The shares of private companies do not have the same marketability.	Pages 8 to 10 of the Brief This portion of the brief points out that the requirement to revalue holdings in widely-held corporations every five years could and most possibly would result in the loss of control. It also points out the difficulties which would result in the marketing of a necessary large block of shares and the adverse effect on the interests of other shareholders. The brief recommends that this proposal should not be implemented.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	3.37 Periodic revaluation would also reduce the "lock-in" effect that might well otherwise occur. If a taxpayer faces a tax on the sale of an investment, and that tax is postponed if he holds on to the investment, he may feel "locked in". As long as he holds, he would have, say, $100 working for him. If he sells, he would have only, say, $90 or $95 to reinvest. Since periodic revaluation would reduce this lock-in effect, it would reduce what might otherwise be an obstacle to the workings of the capital market. Revaluation would also make it feasible for the government to classify more corporate reorganizations and mergers as tax-free transactions than would otherwise be the case, thus removing a tax barrier that might otherwise have impeded transactions that are desirable for economic reasons. Finally, it would reduce the tax postponement which would otherwise result from the treatment suggested in paragraph *3.42* to those cases where the lack of marketability of the assets made the treatment compelling.	

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	3.38 The process would not begin until five years after capital gains become taxable. Beginning in the fifth year, individual taxpayers would revalue their holdings of shares of widely-held Canadian corporations in each year in which they attain an age that is divisible by five. Corporations would also revalue their holdings of these shares every five years, likely on the fifth anniversary of incorporation and each other anniversary divisible by five. Dispersing the valuation process through a five-year cycle would reduce the pressure in any particular year—the pressure of the work load on the administration and the pressure that might otherwise develop on market prices every five years. To further disperse this latter pressure, it is proposed that revaluation take place as of the end of the month in which the significant birthday or anniversary takes place.	

APPENDIX "E"

SUMMARY

of the

BRIEF OF THE EXECUTIVE COUNCIL

of

THE CANADIAN CHAMBER OF COMMERCE

on

PROPOSALS FOR TAX REFORM

and for costs which previously were neither deductible nor depreciable, the Executive Council of the Chamber regards as indefensible the disallowance of entertainment expenses and the expense of attending legitimate conferences. Abuses should be stopped, but this can be done under present law.

PENSION PLANS AND RETIREMENT SAVINGS

To insist that 90% of the investment of pension and retirement funds be invested in Canadian securities may endanger the safety of these funds and unnecessarily push up the cost of Canadian securities and therefore of pensions. Rules limiting pension fund investments should classify as Canadian securities shares in a foreign parent company which has substantial operations in Canada and which lists its shares on a Canadian exchange.

RESOURCE INDUSTRIES

The Executive Council supports the resource industries' position that incentives should be designed to encourage the exploration for and development of Canada's resources, keeping in mind that we are in competition for such exploration and development with other countries. It supports the proposed provisions enabling persons not in the resource industries to participate more fully in these worthwhile ventures.

ELECTRIC, GAS AND STEAM UTILITIES

Regardless of what happens to the corporate tax on these companies after it leaves the companies, the shareholders should be treated in all respects in the same manner as shareholders of other Canadian companies.

CO-OPERATIVES AND CREDIT UNIONS

The Canadian Chamber has long protested what it considers to be an unfair tax advantage extended to co-operatives and credit unions which compete directly with corporations, subject to full tax on corporate earnings. We therefore repeat from the 1969-70 Chamber Statement of Policy that "we urge that in taxation matters a co-operative should be treated like an ordinary corporation".

AVERAGING

The Executive Council agrees with the proposal to permit some averaging of income for all taxpayers, but the system described seems unnecessarily restrictive.

RATE STRUCTURE

It is most important to lighten the proposed tax load of the middle income group as much as possible since in this area there is great potential for savings and therefore economic growth. It is equally important that the 50% maximum rate become the cornerstone of Canada's future tax system.

INTERNATIONAL

(a) **Foreign Source Income**

The Executive Council appreciates the White Paper's intent to put a greater emphasis on the negotiation of tax treaties with foreign countries and the recognition of the source country as the taxing country with provision to allow foreign corporations to flow dividends back to Canada tax free. Care must be taken to safeguard existing incentives favouring our export trade.

(b) **Canadian Source Income**

Non-resident owned corporations have been useful vehicles for investment in Canada and should not be discouraged. The Council is concerned about the proposals to tax non-residents on their Canadian property gains on the dispersal of real property, shares of closely-held companies and shares of widely-held companies where the non-resident is selling out of a holding of 25% or more.

The Canadian Chamber of Commerce
1080 Beaver Hall Hill
Montreal 128, Que.

1970

The Executive Council commends the Government on proceeding by the White Paper route to tax revision, thereby permitting the very desirable extensive public reviews of proposals before legislation is introduced. The Brief deals with the effect of the total proposals as a package on national objectives as well as presenting specific recommendations on major proposals.

There is recognition of the need for tax reform at this time. While the White Paper has many constructive points, its total effect would seriously harm Canada's growth, prosperity, and employment. The Executive Council of the Chamber recommends that the government reconsider the total structure in the light of the following considerations and recommendations which are aimed at giving top priority to economic expansion, investment in Canada's growth and development and increased employment opportunities for Canadians.

NATIONAL OBJECTIVES

(a) **Canada's Economic Objectives**

The first economic objective is prosperity for all Canadians. Priority must be given to generating wealth if Canadians are to have a reasonable standard of living. To grow, Canada must channel the largest possible share of national income to savings for investment and a reasonable amount to consumption to allow living standards to rise progressively. The White Paper would have exactly the opposite effect because in total it is one of the heaviest tax increase proposals ever made by a Canadian government.

By increasing the tax burden on foreign investors, increasing government burdens on Canadian business and reducing the savings potential of Canadians, it directly opposes our national objective of increasing investment and thus employment and incomes for Canadians.

(b) **Canada's Competitive Position**

By heavily increasing taxes on middle income brackets, the White Paper would encourage our most knowledgeable and productive people to move to where their net earnings would be sharply higher. It reduces incentives for new investment and increases the tax burden, thus making Canada less competitive as a location for investment in growth. Capital gains taxes are also more onerous than in those few other countries which use this form of taxation.

(c) **Inflation**

Inflation, which has already reached crisis proportions, is assured when government makes excessive demands on national income. The proposed redistribution of wealth transfers income from those who can save to those who cannot save, further fanning the fires of inflation by reducing the amount available for investment or productivity gains and increasing consumption.

(d) **Incentives for Growth**

Economic growth can come only from successful business, and in Canada this means that small businesses must be encouraged. A policy of taxation incentives to assist capital accumulation by small businesses would be in the national interest. Elimination of double taxation of corporate incomes is a significant policy proposal oriented towards investment in Canada's growth.

No matter what level of social redistribution of wealth Canadians desire, their desires will be frustrated unless they first ensure that their business system is allowed to compete in the world, both in sales of products and services and as an earner of competitive return on investment.

RECOMMENDATIONS

CLOSELY-HELD AND WIDELY-HELD CORPORATIONS

There should be no difference between the treatment afforded a widely-held company and its shareholders on the one hand, and a closely-held company and its shareholders on the other hand. Different treatment would be discriminatory and, we believe, unworkable in practice.

INTEGRATION

Full integration should be permitted for dividends from all Canadian companies received by Canadian residents.

CAPITAL GAINS TAX

The Canadian Chamber has always resisted capital gains tax because inflation causes it to be a tax on capital, because of the immense record keeping task it would pose for every Canadian, and because the amount of revenue obtained is not justified by the added effort placed on both government and taxpayers. Nevertheless, recognizing that the Canadian tax structure has offered a major premium for short-term speculation yielding capital gains that should really be classified as income, it is recommended that:

1) Provided there is full integration of personal and corporate income, all capital gains realized on the disposition of assets held for less than three years should be taxed at full income rates and losses should be allowed in full. Where assets are held for more than three years, 50% of the gains should be taxed and 50% of the losses should be deductible.

2) There be no tax on unrealized gains, and no deemed realization on death.

3) Gains arising from the sale of a principal residence and from personal property held for personal use and enjoyment should not be taxable.

4) If the foregoing proposals are not accepted, we are convinced that a Canadian capital gains tax should be at no higher rate than that in competitive countries.

ESTATE AND GIFT TAX

(a) Inter vivos gifts between spouses be treated the same as testamentary gifts, i.e. the donee take over the gifted property at the cost basis to the donor.

(b) Provision be made so estate and capital gains tax will not overlap.

SMALL BUSINESSES

Small businesses that require capital for expansion purposes should be granted special incentives. The effect of the White Paper would be to eliminate the incentives for growth that are currently incorporated into the tax system.

ALLOWANCES OF EXPENSES AND CHILD EXPENSES

While it approves the proposals to provide a deduction for employment and child care expenses

Submission
on

PROPOSALS
FOR TAX REFORM

by
The Executive Council
of

THE CANADIAN CHAMBER OF COMMERCE

PREFACE

This submission is presented in the name of, and on behalf of, the Executive Council of the Canadian Chamber which acts during the interim between the meetings of the National Board of Directors. The following views are based on, and derived from the policy declarations of the Chamber.

The Canadian Chamber of Commerce is the national voluntary federation of over 800 autonomous Boards of Trade and Chambers of Commerce (the terms are synonymous) in communities throughout Canada.

These community Boards of Trade and Chambers of Commerce exist to promote civic, commercial, industrial and agricultural progress in the areas in which they operate. Seventy-five per cent of them serve communities of less than 5,000 population. In addition, the Chamber has some 2,700 corporation members comprising businesses of all sizes and in all parts of Canada as well as twenty-five national business and professional association members.

The Chamber, therefore, is representative of the full range of business in Canada: small businesses, agriculture, large businesses, unincorporated businesses, sole proprietorships, partnership , professionals. Being so broadly representative, the Chamber is fully aware of the great difficulty involved in formulating a tax system which is fair to all Canadians and at the same time makes cognizance of the special needs of particular entreprises.

The Chamber, obviously, represents people of various political views and affiliations; however, they subscribe to basic common principles which have been stated as follows:

"COMPETITIVE ENTERPRISE

Canada's economic system is based upon competitive enterprise. This system. which permits maximum individual freedom, encourages the exercise of individual initiative, broad dispersal of decision-making and the most economic allocation of human and material resources. It promotes dynamic economic growth and a steady rise in living standards. One of the major roles of government in such a system is to maintain an equitable and favourable climate for private action.

The operation in Canada of the competitive market economy, motivated by opportunities for profit and the dangers of loss, is responsible in large measure for the improvements in social and living standards which have been achieved over the years. The competitive enterprise system develops maximum managerial capabilities, technical knowledge, operating skills and competitive attitudes required for sound growth. The profit motive exercises a determining influence upon the use of resources, the level of savings, the volume of investment, and it compels private enterprise to operate efficiently.

FINANCE AND TAXATION

It is essential that the financial policies of the governments contribute to the achievement of a rate of economic growth, maximum employment and relatively stable prices in order to promote rising standards of living for all Canadians."

The "Proposals For Tax Reform", tabled by the Minister of Finance on November 7, to which this submission is addressed, have been examined in the light of the principles of the Chamber set forth on page 2 hereof.

CONTENTS

INTRODUCTION

1. Before discussing the White Paper itself, we must offer the Government our sincere congratulations on demonstrating the sense of national responsibility inherent in proceeding with the White Paper approach to tax reform. We are deeply conscious of the implications of placing such important and far-reaching proposals on the table for discussion in depth by all sectors over a lengthy period of time. Major tax reform proposals inevitably attract a great deal of criticism, but we consider it to be of vital importance to our long-term national objectives for there to be ample opportunity for these criticisms and counter proposals to be aired before Parliament is asked to act on legislation.

2. Since the Government has provided this opportunity for public discussion of its tax reform proposals, it becomes a serious responsibility for all sectors of society to make their views known. We therefore submit this brief in a spirit of full co-operation with Government in its attempt to develop legislation most likely to provide maximum advantages for Canada as a whole.

3. Income Tax is one of the most important components of the total system of fiscal policies, and this system in turn determines the nation's prosperity or economic direction. Thus, any major reform of fiscal policy can be considered constructively only in terms of the nation's economic objectives and the impact to be expected from the proposals. The first section of this brief therefore deals with national objectives and the way in which these will be affected by the Government's proposals.

4. The second section deals with our specific comments and suggestions on the main recommendations. We have not attempted to deal with each detail described in the White Paper.

NATIONAL OBJECTIVES

(a) Canada's Economic Objectives

5. An assessment of the ultimate economic impact of all the proposals taken as a total package give us such major cause for concern that we believe it important to devote much of the first part of our brief to this subject. For it is this total impact which presumably indicates the general trend of Canadian policy, and it is this general trend which concerns us as much as the possible impact of any single proposal taken by itself. To some extent, therefore, our comments on the broad effects of the sum total of all proposals may not be related specifically to any particular proposal.

6. The nation's first economic objective is prosperity for all Canadians. This can be achieved only through the generation of the maximum amount of wealth, with the broadest possible equitable distribution of that wealth amongst our people. Such a statement may sound like a truism, but it is precisely because of our assessment that the total effect of the proposals runs contrary to this objective that we feel obliged to record it at the outset. Apparent emphasis by Government on equity is in conflict with the need for priority to be given to generating new real wealth if Canadians are to have reasonable living standards.

7. Certainly fairness, an equitable sharing of the tax burden – having regard to ability to pay, a general recognition that if any apparent inequities do exist, they are designed for important positive reasons, are all desirable in any tax system. Constructive changes to the tax structure should be made whenever the need becomes apparent, and some such changes are proposed in the White Paper. The document is so written as to give the reader the impression that inequity is rampant, that tax avoidance or evasion by the "well-to-do" is so widespread as to force "major structural reform". Even if this were true, which it is not, it would represent only severe criticism of government through the years for failure to properly administer and enforce existing laws and regulations to wipe out "loopholes".

8. There can be no continuing general improvement in the standard of living unless resources are used to generate maximum wealth, so this has to be our first concern if Canada has in truth the objective of high living standards. There are three economic divisions of a nation, or three broad purposes for which national income must be used – for consumption, for government and for investment. At any one time, national policies lean preponderantly in one of these directions, with the emphasis moving from time to time, as dictated by current conditions. In Canada, we have moved significantly to a government-oriented economy in the last decade, which has substantially contributed to the inflationary crisis. Such countries whose policies are investment-oriented are rapidly gaining in the world's economic race. Countries which have been consumer-oriented for too many years have undergone recurring monetary crises. Government orientation, or assumption by government of a rapidly growing share of national income, can only be categorized as a low growth rate situation.

9. Technological development since the war has proven that economic expansion and rising living standards are achieved through sharply-rising investment of capital, with

concentration in the most modern, the most technological and capital intensive industries. Thus, to grow, Canada must follow policies which will channel the greatest possible share of her national income to savings for investment and a reasonable amount to consumption to allow living standards to rise progressively.

10. While it is held out as a tax reform proposal, the White Paper is in fact one of the heaviest tax increase proposals ever made by a Canadian government thus making it difficult to discuss tax reform on its merits. It proposes to increase the demands of government on the economy by over $600 millions, which has been estimated by the Government of Ontario as $1,300 millions*.

11. There is also an extensive shift of the tax burden on to the middle and upper bracket tax payers. It is acknowledged that it is this group that accounts for virtually all our savings, and the combination of the outright tax increase with this shift of burden would have a most adverse effect upon total national savings. The estimate of this effect contained in the White Paper amounts to $500 million. Many informed estimates place this figure much higher.

12. This heavy reduction in the savings potential of Canadians will have to be made up by obtaining the extra capital from foreign investors, if adverse economic effects are to be avoided. We are now entering a period of acute world capital shortage, and the U.S., which has been the World's great capital exporter, is now at times a net capital importer. Other countries, with no great capital surplus and no long tradition of investment in Canada, will make their foreign investments where these will earn the highest return. Canada can no longer assume that it will automatically obtain from abroad whatever capital it needs. By increasing the tax burden on foreign investors, by increasing government burdens on Canadian business, and by reducing the savings potential of Canadians, the White Paper proposals are directly opposed to our national objective of increasing investment and thus employment and incomes for Canadians.

13. It is a matter of historical record that economic growth has benefitted the poor relatively much more than the wealthy. The percentage of population that may be considered as "wealthy" in the developed countries has not changed noticeably for centuries. But the percentage that can truly be considered as "poor" has dropped drastically and almost in direct relationship to economic growth. We have only to compare the situation of the lower income levels in our country with that of the "poor" in the less developed countries to recognize the vast improvement in their living standards that has resulted from economic growth. But only real growth can achieve this purpose. Government's attempt to hand out higher incomes without having real economic expansion as a base can only cause inflation, destruction of monetary unit values, unemployment and disaster for the very people it is designed to assist. In the end, it is always the poor who suffer most from inflation.

14. Economic growth can come about only through the investment of capital or savings, whether by Canadians or by foreingners as well as the efforts, the knowledge and the skill shown in using the capital and savings available. Thus, to help our less fortunate, to offer

* based upon a memorandum on the "Revenue Impact of the Federal White Paper Tax Reform Proposals" presented by the Hon. Charles MacNaughton, Treasurer of Ontario and Minister of Economics to the Ministers' of Finance Meeting, February 2 - 3, 1970.

employment opportunities for our fast-growing work force, and to raise living standards for all Canadians, we must have economic and fiscal policies which favour savings and investment by Canadians and which do not impose disincentives on investment in Canada by foreigners.

15. These policies do not exist for today only - they will be equally valid for many years to come. Until Canadians have a sufficiency and no longer seek increases in living standards as a first requisite of existence, we should have an economy that is investment-oriented. This means that the increasing flow of wealth from new investment should continue to be directed towards still more growth. A tax structure should not be designed to borrow future income to finance current consumption needs. The White Paper tax structure is designed to increase heavily the burden of taxation of future income.

(b) Canada's Competitive Position

16. To achieve economic growth in the modern world, a nation must be competitive. There has been a significant worldwide movement towards freer trade in which Canada has been a leader, the result being the opening up of the Canadian economy to greater competition, particularly from low-wage countries. While much of the overt change has been in the area of tariffs and dumping, there are many other factors affecting costs or profitability of those industries which generate the nation's wealth, provide its workers with employment, and its people with advancing living standards. Taxation of incomes and incentives for investment are two very important aspects where Canada must be competitive if it is to be an attractive area for investment in growth whether by Canadians or foreigners. Thus, to achieve our objective of growth we must ensure that we do not adopt taxation or other policies which are not competitive with those of the nations with which we must stand comparison for investment choice purposes.

17. The White Paper proposals would seriously affect Canada's competitiveness in several important areas. First, they increase the tax burden on the middle income brackets which contain so many knowledgeable and productive people. Their tax burden would be further increased as compared with the corresponding U.S. burdens, and it is in the U.S. that these people can find opportunities to use their talents to the fullest as well as living in the type of community in which they would be comfortable. Thus, the competitive urge for such people to move South – or against U.S. citizens moving North – would be very great. Yet it is on the knowledge and skills of these same people that we must rely if we are to achieve any real growth.

18. The second major competitive area in which the White Paper proposals threaten Canada's prosperity is the treatment of investment in its various forms. In the name of equity, it eliminates incentives that have previously been extended to certain industries. (It is always essential to keep incentives to the minimum necessary to achieve the objective, but to drop below this minimum is to ensure that objectives cannot be met.) The capital gains tax provisions are more onerous than the comparable U.S. provisions, thereby not only eliminating what had been a significant Canadian incentive for investment but at the same time giving us a non-competitive tax cost.

19. A capital-importing country cannot afford to make itself non-competitive in the world search for capital. For many years, Canada has imported a high proportion of U.S. surplus capital because U.S. investors were comfortable with their Canadian neighbour, because they relied on our political and economic stability, and because management of Canadian operations did not pose major new legal and other problems. But the U.S. no longer has surplus capital so that today its capital going abroad seeks diligently to find the best return. What is more, the U.S. has recently increased sharply its worldwide economic penetration, and it is no longer hesitant to export capital to other countries where wage rates, taxes and other costs are much lower than those of Canada. U.S. technology can be employed anywhere. This is no time for Canada to take steps to dry up the flow of foreign capital so urgently needed for growth.

20. If we are to introduce a capital gains tax, it is of the utmost importance, from the competitive viewpoint, that it be strictly limited to realized gains, and that it also recognize that there be no deemed realization on death. At the same time, a tax on long-term capital gains should recognize the effects of inflation on stated values, so as to avoid what is in truth a tax on capital itself.

(c) Inflation

21. A great threat to any nation's prosperity is inflationary advances in the cost and prices of its goods and services, making these less competitive both in domestic and foreign markets. Inflation has reached almost crisis proportions in the developed world. Canada, as a small power in relation to the U.S., will inevitably feel inflation's effects more quickly and more devastatingly. A continuing high rate of inflation will destroy our competitiveness, curtail our living standards, put many Canadians out of work and impoverish a vast number of Canadians (particularly widows and older citizens) whose incomes are fixed for one reason or another.

22. Inflation is virtually assured when government makes excessive demands on national income. Government costs increase the tax burden, making our products less competitive and plant expansion less attractive. Government redistribution of wealth transfers incomes from those who save to those who cannot save, thus both reducing the amount available for investment or productivity gains and increasing consumption. Interest costs automatically rise. Investment dries up, costs rise and prices also rise, so that all Canadians, more particularly those in the lower-income levels, suffer.

23. Because inflation is the very opposite of what Canada needs today, the White Paper proposals to increase and shift the tax burden are directly opposed to Canada's best interests.

(d) Incentives for Growth

24. The fact that real living standards for Canadians have increased phenomenally over the past fifty years, that personal incomes have risen several times as fast as the cost of manufactured and resource products, is due primarily to the effects of the technological revolution which in turn is the direct result of the effective incentives of the private capital system. A high proportion of the new technical knowledge has been developed by the research laboratories of business or financed by business, and virtually the entire

reduction of this knowledge to commercial products has been carried out by free enterprise business. As a result of technological change and automation, vastly increased volumes of the products needed for everyday life can be produced at progressively lower real costs, although recent inflationary increases in wage rates, taxes and other costs have forced prices up in some industries.

25. It is private enterprise business which accounts for Canada's sharply rising total wealth generation over the years, and thus for higher incomes and employment for Canadians. Furthermore, it is important to recognize that the nation's massive new financial commitments to education, to health and to welfare, as well as the rapid increase in expenditures on recreation and leisure, are in fact paid for through the generation of new real wealth by the business sector and the distribution of that wealth in the form of wages, purchases of materials, donations to educational and health institutions and taxes.

26. It is because Canadians must rely heavily on business, including agriculture, for their material welfare that Canadian business has a duty to explain the impact of proposed tax reforms on its ability to succeed in its tasks. If Canada is to have reasonable living standards and employment opportunities, she must be an attractive base for productive business whether it be domestic or international, large or small.

27. Small business has always been important in Canada as the backbone of much of Canada's employment and social structure. Fast-growing companies frequently start as small businesses. Thus, a national objective of economic growth demands that successful small businesses be encouraged rather than discouraged. The great difficulty for small business is to obtain the capital needed for growth while the owner retains his ownership (and this latter is essential to ensure maximum growth). Therefore a policy of taxation incentives to favour capital accumulation by small businesses, is in the national interest.

28. It is recognized that such an incentive, combined with the full integration of corporate and personal incomes for shareholders of closely-held corporations poses a problem of equity between incorporated and unincorporated businesses, but a requirement to incorporate in order to obtain a tax incentive does not seem unfair, and might be necessary to ensure that any incentive applies only to a definable business for a limited period.

29. Recognition by the Governement of a principle long supported by the Chamber - that of elimination of double taxation of corporate incomes - is a significant policy proposal oriented towards investment in Canada's growth. But by drawing an arbitrary line between closely-held and widely-held companies the Government is introducing a new inequity and also constructing a massively complex tax system including important disincentives against some types of investment. The Government's argument for full integration in closely-held companies, which is essentially that developed by the Carter Commission for all companies, recognizes the truth that income can be earned only by people, whether it be earned through their work or through the investment fo their property in a company, and that each person's income should be taxed once, regardless of its source. We cannot accept the reasoning that income earned through corporate investment changes its nature, depending upon the number of share-holders in the

company. The problems of moving over to a policy of total integration of corporate and personal incomes would call for a transitional adjustment period but would certainly improve the equity of the tax system. The full integration principle is being urged on all nations by the International Chamber of Commerce, but a move by Canada to be among the first would provide an important incentive for investment by Canadians.

30. The Canadian Chamber has long resisted a capital gains tax for several reasons. Canada desperately needs investment in growth and should therefore provide incentives for investment. A capital gains tax is incredibly difficult to administer unless every Canadian keeps complete records of everything he buys and sells. History shows us that recorded capital gains are frequently in fact the result of inflationary price increases, so that to tax them would be to tax capital itself. On balance, the relatively small income to be attained by Government by this route is much more than offset by the cost to all Canadians of complying with the tax and by the effect on incomes and employment of eliminating incentives for investment.

31. Nevertheless, the Canadian tax structure has placed a premium on speculative short-term profits which result from transactions entered into solely for the purpose of achieving such profits classified in the past as capital gains. These profits are in fact income, and should propertly be taxed as such, but any changes either as to the nature or the time limit within which both sides of the transaction take place, must be defined very carefully.

32. Under no circumtances should tax be calculated on a stated gain which is in fact due to inflation, since to tax capital as such would be to introduce the worst type of disincentive for investment, and would also be inequitable in any income tax system. A capital gains tax on a main residence, on works of art and similar items normally purchased out of tax-paid income is so difficult to administer or comply with, while also being inevitably a tax on an inflationary gain in stated value, that it should not be adopted.

33. In submitting these views on the fundamental implications of the White Paper proposals, the Executive Council reaffirms the Canadian Chamber's support for tax policies designed to assure all Canadians of the highest possible living standards and employement. These objectives are possible through the investement of capital in Canadian growth industries and therefore through fiscal policies oriented towards increasing investment rather than towards consumption or government. No matter what levels of social redistribution of wealth may be desired by Canadians, their desires will be frustrated if they do not first ensure that their business system is allowed to compete in the world, both in sales of products and services and particularly as an earner of competitive return on investment.

34. If a high level of investment and productivity is achieved, Canadians will not have to be preoccupied with universal social welfare programs because they will be earning high average incomes.

(e) Federal-Provincial Considerations

35. The Chamber's views on federal-provincial considerations can be put quite briefly. We

regard as of overriding importance the necessity that whatever final form it takes, tax reform must carry with it the support of the provinces. We appreciate the government is aware of this necessity and we wish to make it clear that the Council of the Chamber concurs in this position.

RECOMMENDATIONS

CLOSELY-HELD AND WIDELY-HELD CORPORATIONS

36. There should be no difference between the treatment afforded a widely-held company and its shareholders on the one hand, and a closely-held company and its shareholders on the other hand. Different treatment would be discriminatory and we believe unworkable in practice.

CAPITAL GAINS AND INTEGRATION

37. Full integration should be permitted for dividends from all Canadian companies received by Canadian residents.

38. The Chamber has long resisted a capital gains tax. Nevertheless, if the government decides that a capital gains tax is to be imposed, then, taking into account the aforementioned views of the Executive Council with respect to National Objectives and the reasons which follow, the Executive Council in addition recommends that:

39. All gains realized on the disposition of assets held, with the exception of gains arising from the sale of a principal residence and from personal property held for personal use and enjoyment, for less than 3 years should be taxed at full income rates and losses should be allowed in full. Where gains or losses are realized on assets held for more than 3 years, 50 per cent of the gains should be taxed and 50 per cent of the losses should be deductible. We are mindful that the line between capital gains and ordinary speculative gains is difficult, but must be drawn so that what is essentially ordinary income is taxed as such. At some point, however, a true capital gain is involved. There should be no mistaking it if a period of up to 3 years is required to qualify for one-half gain treatment. This would confirm the generally held view that, however difficult it is to define, there is a difference between income and true capital gain. In addition, if true capital gains are to be taxed, it is of great importance to take into account the problem of inflation. While not a perfect offset, the 3-year proposal would serve the purpose of recognizing the inflation problem and, at least if inflation can be kept under reasonable control, might eliminate the necessity of complicated indexing which we feel would otherwise be required. The treatment set out above for capital gains is predicated on the acceptance of our proposal for full integration for all Canadian shareholders; if this proposal is not accepted, we are convinced that a Canadian capital gains tax should be at no higher rate than that in competitive countries.

40. There should be no tax on unrealized gains. The Executive Council is strongly opposed to the 5-year deemed realization tax on the shares of widely-held companies. As has been pointed out by many others, in addition to valuation problems, such a tax would provide a strong inducement for Canadians to invest outside of Canada and a strong inducement for closely-held companies, whether owned in Canada or abroad, not

to go public. In addition, it is most unfair to the foreign owners of Canadian companies who, partly in response to incentives in our existing tax system, have heretofore sold shares to the Canadian public.

41. We believe that the combination of full integration and our recommended uniform treatment of all true capital gains will provide a strong incentive for investment in Canada by Canadians.

42. We are concerned about the implications of the proposed rule that a deemed realization would occur when a taxpayer gives up Canadian residence. We appreciate the necessity of preventing tax avoidance in this area but the full application of the rule would be unduly harsh in terms, for example, of business executives or technical employees who at the request of their employer move from one jurisdiction to another, or in terms of older persons who for health reasons have to retire to a warmer climate and who for the rest of their lives will need all the income they can generate from their savings to maintain a reasonable standard of living. We strongly recommend that this proposed rule be reconsidered.

ESTATE AND GIFT TAX

43. Under the White Paper proposals inter vivos gifts will be treated for capital gains tax purposes as a sale at fair market value both from the point of view of the donor and donee but when gifts are made on death the heirs and beneficiaries of a deceased taxpayer will take over the assets of the deceased at the same cost basis as the deceased. Such cost basis would be increased by the death taxes (which should include Provincial succession duties) paid on the portion of the value of the assets in question that would, if then disposed of, be subject to the capital gains tax. To the extent, however, that any such assets are disposed of to pay estate duties or otherwise there will be both estate duties and capital gains tax payable on the difference between the aforementioned adjusted cost basis and the fair market value of the assets.

44. Under the estate and gift tax laws which were enacted as a result of budget resolutions introduced on October 26, 1968, property can be transferred between spouses either inter vivos or on death without any gift or estate tax. In addition, the new estate and gift tax laws provide for the integration of gift and estate tax. In view of the foregoing we recommend that:

(a) inter vivos gifts between spouses be treated the same as the proposals in the White Paper for testamentary gifts, that is the donee take over the gifted property at the cost basis to the donor.

(b) provision be made so that estate and capital gains tax will not overlap. One way of doing this would be for the estate tax to apply to the cost of the assets to the deceased and for the capital gains tax to apply to the difference between the fair market value and the aforementioned adjusted cost when disposed of.

SMALL BUSINESSES

45. The Council is of the view that it is important to encourage savings and growth and for that purpose there should be a special incentive granted to small businesses that require capital for expansion purposes.

46. The removal of the split rate of tax will mean withdrawal from a small incorporated business of relief from tax of up to $10,000 per annum. This benefit derived under the present system is not as generous as many believe it to be, particularly when funds are removed from the company, but as long as the funds remain in the company there is a valuable deferral which over a number of years becomes a sizeable amount. The proposal for full integration for closely held companies to some extent lessens the impact of the removal of the split rate. In addition for closely held companies with substantial non-taxable earnings the partnership election which to some extent can convert a tax deferral into a tax saving may be of considerable value. However, particularly when considered in conjunction with the capital gains tax, full integration and the partnership election are not sufficient offsets.

47. We are of the view that the tax system should continue to retain as an incentive for growth a benefit for small businesses.

NOTHINGS, ENTERTAINMENT, CONVENTION AND EMPLOYMENT EXPENSES AND CHILD EXPENSES.

48. We lump our comments on the proposals in connection with the above because they involve a single principle - the deduction of the cost of earning income.

49. We applaud the proposals to provide a deduction for employement expenses and child care expenses for income earning parents and capital cost allowance for costs which previously were neither deductible or depreciable. These reforms are long past due and probably contribute as much to fundamental fairness in the tax system as any other of the proposals.

50. The proposals not to allow any deductions for so-called entertainment expenses and the expense of attending conferences associated with one's business or employment are indefensible in principle and constitute a discrimination between business pratices. We agree that the taxpayer should be put to strict proof that such expenditures were reasonable and laid out for the purpose of earning income from his business, profession or employment, and were not personal expenses. If he is able to meet such a test, there is no valid reason he should not bc allowed them as deductions in computing his income.

51. We would also point out that for many small businessmen, "entertaining" clients or customers at lunch or dinner is the only way they can effectively advertise their goods or services. Ordinary type advertising campaingns are beyond their means, and, where a business is of the type that depends on only a few customers, the usual type of advertising may be ineffective.

PENSION PLANS AND RETIREMENT SAVINGS

52. The Executive Council concurs in the statement that it is in the national interest to encourage personal savings plans for retirement on an equitable basis for all Canadians, recognizing particularity the growing importance of such pools of capital for investment in Canada's growth. Our concern is with the implications of a still more stringent limitation on the freedom of such funds to invest in securities of foreign corporations

53. Canada's development in recent years, particularly into the technologically intensive

industries, has been increasingly through subsidiaries of foreign corporations which, in turn, obtain most of their technology from their parent companies. In some cases, these subsidiaries have issued shares to the public; in many cases they are wholly owned. Because Canada needs such industries if she is to make the fullest use of her resources, they should be encouraged to locate here, but incentives to operate in Canada may be greatest if they are wholly owned.

54. It is thus inevitable that Canadian investors, such as pension fund trustees who must maintain balanced portfolios in which the best protection calls for investment in the most dynamic industries, will find it impossible to buy Canadian securities to meet these objectives without bidding up the price of the very limited supply. There will not be enough Canadian stocks available in dynamic growth companies covering a wide spectrum of industry to meet the needs of our institutional and individual investors. Thus, to insist that 90% of the investments of such funds must be invested in whatever Canadian securities may be available is to risk endangering the security of pension funds and to push up the cost of Canadian securities unnecessarily.

55. It should be recognized that the foreign parent company is investing substantial sums in Canada. Therefore it is submitted that the rules limiting pension funds investments should classify as Canadian securities shares in a foreign parent company which has substantial operations in Canada, and which lists its shares on a Canadian exchange.

RESOURCE INDUSTRIES

56. The Executive Council welcomes the government's statements in the White Paper which indicate a recognition of the need for special incentives for resouce industries. It does not believe it can make a specific contribution to the debate about the form and extent which these incentives should take. The Executive Council supports, however, the resource industries' position that the incentives should be designed to encourage the exploration for and development of Canada's resources. The White Paper proposals include sharp reductions in incentives for minerals' and other resources' exploration and development, and we must constantly keep in mind that we are in competition for such exploration and development with other countries. We regard the benefit of such activities to all Canadians as far outweighing losses of neutrality, equity, or tax revenue which these incentives represent. Reduction in activity by the mining or petroleum industries would be detrimental to Canada's economy as a whole, and result in disproportionate detriment for specific regions in Canada whose economies depend on vigorous mining and petroleum industry activity.

57. We note with approval the provisions proposed in the White Paper to enable people whose main business is not in the resource industries, to participate more fully in these worthwhile ventures.

ELECTRIC, GAS AND STEAM UTILITIES

58. Since the introduction of the White Paper, the Minister of Finance has announced some changes with respect to credit for corporate tax on dividends from utility companies, the regular corporate tax from which is paid through to the provinces by the federal government. We appreciate this is a very difficult question to deal with particularly where in some parts of Canada the tax is rebated right back to the Company

and back through to the customers where in other provinces the tax dollar is stopped in the provincial treasury. We regard this as essentially a matter as between the federal and provincial governements and inter-governmental transfers. Regardless of what happens to the corporate tax on these companies after it leaves the companies, we feel that the shareholders should be treated in all respects in the same manner as shareholders of other Canadian companies and credit given against personal tax for the amount of tax initially paid.

59. Not to do this results in another distortion of individual investment decisions which tends to negate some of the more desirable features of the tax reform proposals.

CO-OPERATIVES AND CREDIT UNIONS

60. The Canadian Chamber has long protested what it considers to be an unfair tax advantage extended to co-operatives and credit unions which compete directly with corporations subject to full tax on corporate earnings. We therefore repeat from the 1969-70 Chamber Statement of Policy that "we urge that in taxation matters a co-operative should be treated like an ordinary corporation".

AVERAGING

61. The Executive Council welcomes the White Paper proposal to permit some averaging of income for all taxpayers, but the system proposed does seem to be unnecessarily restrictive, and we recommend that the proposals be revised to provide a real measure of relief.

RATE STRUCTURE

62. The government has, for estimating the impact of the tax reform proposals, resources, and access to information, unmatched in the private sector. The governement therefore carries a heavy burden of care not to underestimate the adverse nor to overestimate the beneficial impact of the proposals in efforts to achieve greater equity.

63. As indicated in the first part of this Brief, under National Objectives, we think it is most important to lighten the proposed tax load of the middle income group as much as possible since in this area there is a great potential for savings and therefore economic growth. In this connection, the Executive Council is strongly of the view that substantial increases in taxes should not be incorporated in a tax reform programme and that the new tax system should be designed to raise approximately the same revenue as the present system both initially and over the implementation period and thereafter. This, for example, could be done by providing in the tax legislation for future increases in the levels at which the rate is stepped up and in particular the "cut-in" point of the maximum rate could be increased from $24,000.

64. We also note that the existence of a top rate of tax of around 50% might offset some of the disincentive effects of the higher rates at income levels below $24,000. This effect would result from the fact that a person would know that there would at least be a reasonably realizable end to rate increase if his endeavours brought him higher income. We, therefore, regard it as essential that the approxiamte 50% maximum rate become the cornerstone of Canada's future tax system.

INTERNATIONAL

(a) Foreign Source Income

65. We applaud the proposals in the White Paper to put a greater emphasis on the negotiation of tax treaties with foreign countries and the recognition of the source country with which Canada has a tax treaty as the taxing country by means of the proposal in such a case to permit "controlled" foreign corporations to flow dividends back to Canada tax free. We are also in favour of any reasonable provisions that may be required to prevent income which would normally be generated in Canada from being diverted to tax haven jurisdistions.

66. We point out, however, that tax havens are sometimes used by Canadian corporations in order to reduce income taxes otherwise payable to foreign jurisdictions rather than as a means of diverting what would otherwise be Canadian source income to foreign jurisdictions, and that Canadian exports have increased because such an advantage is available. This is a recognized method of operating in international trading circles, and is understood by foreign governments involved as a proper mechanism to assist the development of business within their jurisdiction. The denial of such a right to Canadian corporations could place them at a serious net disadvantage opposite foreign companies, and could damage Canada's export trade. In this connection, it is our understanding that the provisions in Sub-paragraph F of the U.S. Internal Revenue Code (which the White Paper proposes to pattern amendments on) are extremely complex and go beyond what is required for Canada to prevent abuses. A U.S. government official stated recently that this provision "is too complex for efficient administration" and that "complexity is very difficult to avoid, but we consider simplification an important goal and intend to weigh it heavily in the process of developing our proposals".

67. In view of the foregoing, we recommend that amendments patterned on Sub-paragraph F not be proceeded with and that the existing provisions of the law be enforced to prevent the diversion to tax havens of income that would normally be generated in Canada.

68. We note that the existing Section 28 (1) (d) dividend exemption is to be retained for several years, at least through 1973, as a transitional measure until an appropriate network of international tax treaties can be negotiated. Under the White Paper proposals, after the transitional cut-off date dividends from countries with which Canada does not have a tax treaty will be subject to a gross up and credit system for source country taxes. If Canada should prove unsuccessful in negotiating treaties with a substantial number of foreign countries, particularly with developing countries, then we are concerned about the implications of the gross up and credit system. First if bona fide business income is in fact taxed at a lower rate in the source country with which Canada does not have a tax treaty this will create pressure to avoid bringing the after tax earnings from such source country back to Canada (which we do not think is desirable) and may also result in the source country imposing a level of tax at least equal to the Canadian level to avoid the difference being sponged up by Canada. This problem may be particularly serious when the source country is a developing country where it is the World's interest to encourage development through the use of private capital and where the developing country may grant tax concessions to encourage foreign investment. Accordingly we recommend that:

69. (i) if Canada is unable to negotiate a broad network of tax treaties then the matter be reconsidered. We can see no great reason for not recognizing the source country as the sole taxing country where Canada does not have a tax treaty as long as potential abuses are adequately dealt with.

70. (ii) in any event, to the extent that treaties cannot be negotiated with developing countries, a procedure be established with appropriate safeguards to prevent tax avoidance, whereby a country could be designated as a developing country which would permit free flow back of dividends on the same basis as would be the case if Canada had a tax treaty with such country.

(b) Canadian Source Income

71. We note that paragraph 6.40 ot the White Paper proposes that the tax rate for non-resident owned investment corporations would be increased to match the proposed 25% rate of the non-resident with-holding tax. The non-resident owned investment corporation has been a useful vehicle for investment in Canada and should not be discouraged. The Executive Council is of the view therefore, that the non-resident owned investment corporation rate should follow the treaty rate if the non-resident owners are resident in a country with which Canada has a treaty. We appreciate the potential for abuse in this area but such abuse could be largely overcome by providing that the treaty rate is only applicable if prescribed information which is satisfactory to the Minister is submitted to establish that all of the non-resident owners are resident in the applicable country with which Canada has a treaty.

72. We are concerned about the proposals in the White Paper to tax non-residents on their Canadian property gains on the disposal of real property, shares of closely-held companies and shares of widely-held companies where the non-resident is selling out of a holding of 25% or more. The Carter Report recommended that Canada should not seek to tax non-residents on their Canadian property gains except those realized in connection with a business carried on in Canada. Since other countries of the World which impose a capital gains tax do not extend such tax to such an extent in its application to non-residents we think there will be considerable difficulty in negotiating amendments to the applicable tax treaties to permit the taxation of such gains. In addition if any such gains are to be taxed we think there is considerable merit in the argument that the rate imposed thereon should be the same as the withholding tax rate provided for in the Income Tax Act or applicable tax treaty.

CONCLUSION

73. There is no disgreement with the need for major tax reform at this time. A major overhaul of any tax system necessarily involves a large number of changes, many of which are interdependent. Thus, it is difficult to support some and to reject others without endangering the total package or causing imbalance that could be detrimental to the entire system.

74. The test for any such total overhaul should be the estimated result of all the changes together. While the White Paper has many constructives points, its total effect would be seriously harmful to Canada's growth, prosperity and employement. We have therefore

tried to develop various specific recommendations to overcome the adverse total effect. We believe that the Government should take the time necessary to reconsider the total structure in the light of our recommendations which are designed to give top priority to economic expansion, investment in Canada's growth and development and increased employment opportunities for Canada.

APPENDIX "F"

NAME: EXECUTIVE COUNCIL OF THE CANADIAN CHAMBER OF COMMERCE

SUBJECT: Proposals for Tax Reform

Analysis of Appendix "E" by Senior Advisor.

This brief has been submitted by the Executive Council of the Canadian Chamber of Commerce. The Executive Council acts during the interim between the meetings of the National Board of Directors. The views expressed in the brief are based on, and derived from, the policy declarations of the Chamber.

The Canadian Chamber of Commerce is the national voluntary federation of over 800 autonomous Boards of Trade and Chambers of Commerce (the terms are synonymous) in communities throughout Canada.

These community Boards of Trade and Chambers of Commerce exist to promote civic, commercial, industrial and agricultural progress in the areas in which they operate. Seventy-five per cent of them serve communities of less than 5,000 population. In addition, the Chamber has some 2,700 corporation members comprising businesses of all sizes and in all parts of Canada as well as twenty-five national business and professional association members.

The Chamber, therefore, is representative of the full range of business in Canada: small businesses, agriculture, large businesses, unincorporated businesses, sole proprietorships, partnership, professionals.

The first section of the brief deals with national objectives and the way in which these will be affected by the White Paper proposals. (Pages 6 to 12).

The second section deals with specific comments and suggestions on certain of the White Paper proposals.

Members of the Committee will observe the conclusions of the brief that are:

"There is no disagreement with the need for major tax reform at this time. A major overhaul of any tax system necessarily involves a large number of changes, many of which are interdependent. Thus, it is difficult to support some and to reject others without endangering the total package or causing imbalance that could be detrimental to the entire system.

"The test for any such total overhaul should be the estimated result of all the changes together. While the White Paper has many constructive points, its total effect would be seriously harmful to Canada's growth, prosperity and employment. We have therefore tried to develop various specific recommendations to overcome the adverse total effect. We believe that the government should take the time necessary to reconsider the total structure in the light of our recommendations which are designed to give top priority to economic expansion, investment in Canada's growth and development and increased employment opportunities for Canada."

The usual summary of present tax laws, White Paper proposals and principal points of the brief is attached.

Name: EXECUTIVE COUNCIL OF THE CANADIAN CHAMBER OF COMMERCE

Date Brief Received:

Principal Subject: Distinction between Closely-Held and Widely-Held Corporations

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act does not distinguish between a widely-held and a closely-held corporation.	4.43 These proposals obviously put considerable importance on the distinction to be drawn between closely-held Canadian corporations and widely-held Canadian corporations. The rules proposed for defining a widely-held corporation are as follows: (1) All corporations with shares listed on a prescribed Canadian stock exchange on the day the White Paper is published would be deemed to be widely-held corporations. (2) All corporations which subsequently list their shares on these exchanges would become widely-held corporations on the day on which their shares are so listed. (3) Corporations which can meet specified tests concerning the number of shareholders and the number of shares held by those shareholders could elect to be classified as widely-held corporations. (4) The Minister of National Revenue would have the power to designate other corporations as widely-held corporations if they meet certain tests relating to number	Page 12, paragraph 36 of the Brief There should be no difference between the treatment afforded a widely-held company and its shareholders on the one hand, and a closely-held company and its shareholders on the other hand. Different treatment would be discriminatory and we believe unworkable in practice.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	of shareholders, dispersal of shares and public trading in shares. (In practice this would mean that most corporations with shares traded "over the counter" would be classified as widely-held corporations.) (5) Once a corporation is classified as a widely-held corporation it would always remain a widely-held corporation. Only corporations incorporated in Canada would be eligible to be treated as Canadian widely-held corporations.	

Name: THE CANADIAN CHAMBER OF COMMERCE

Date Brief Received:

Principal Subject: Integration

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act does not contain any provisions requiring integration.	4.19 The government's proposal is to create one set of rules for the closely-held corporation—the incorporated proprietorship or partnership—and another set of rules for the widely-held, public corporation. This distinction reflects the difference in the relationship between the two types of corporations and their respective shareholders. It also reflects the fact that, by and large, the closely-held corporation competes with proprietorships, partnerships and of course with other closely-held corporations, while the public corporation competes with other public corporations, both Canadian and foreign. 4.24 In the case of those corporations which are not to be treated as partnerships, parity with the shareholders of partnership corporations would be achieved in two steps. There would be a tax of 50 per cent on the taxable income of the corporation. However, when the net profits are distributed to the shareholders, credit would be given for the full amount of the tax paid by the corporation on those profits. 4.36 However, the government does want to reform the dividend tax credit. It proposes to replace the existing credit with a system giving Canadian shareholders credit for one-half the Canadian corporation tax paid by the corporation on the profits from which the dividend is paid.	Page 12, paragraph 37 of the Brief Full integration should be permitted for dividends from all Canadian companies received by Canadian residents.

Name: THE CANADIAN CHAMBER OF COMMERCE

Date Brief Received:

Principal Subject: Capital Gains Tax

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act does not impose a tax on capital gains.	The proposals of the White Paper respecting capital gains were reviewed on Pages 8 to 20 of the Special Study entitled, "Discussion of Principal Points of White Paper - Part 2" submitted on February 11, 1970.	Pages 12 and 13, paragraphs 38, 39, 40, 41, 42, 43 and 44 of the Brief 38. The Chamber has long resisted a capital gains tax. Nevertheless, if the government decides that a capital gains tax is to be imposed, then, taking into account the aforementioned views of the Executive Council with respect to National Objectives and the reasons which follow, the Executive Council in addition recommends that: 39. All gains realized on the disposition of assets held, with the exception of gains arising from the sale of a principal residence and from personal property held for personal use and enjoyment, for less than 3 years should be taxed at full income rates and losses should be allowed in full. Where gains or losses are realized on assets held for more than 3 years, 50 per cent of the gains should be taxed and 50 per cent of the losses should be deductible. We are mindful that the line between capital gains and ordinary speculative gains is difficult, but must be drawn so that what is essentially ordinary income is taxed as such. At some point, however, a true capital gain is involved. There should be no mistaking it if a period of up to 3 years is required to qualify for one-half gain treatment. This would confirm the generally held view that, however difficult it is to define, there is a difference between income and true capital gain. In addition, if true capital gains are to be taxed, it is of great importance to take into account the problem of inflation. While not a perfect offset, the 3-year proposal would serve the purpose of recognizing the inflation problem and, at least if inflation can be kept under reasonable control, might eliminate the necessity of complicated indexing which we feel would otherwise be required. The treatment set out above for capital gains is predicated on the acceptance of our proposal for full integration for all Canadian shareholders; if this proposal is not accepted, we are convinced that a Canadian capital gains tax should be at no higher rate than that in competitive countries. 40. There should be no tax on unrealized gains. The Executive Council is strongly opposed to the 5-year deemed realization tax on the shares of widely-held companies. As has been pointed out by many others, in addition to valuation problems, such a tax would provide a strong inducement for Canadians to invest outside of Canada and a strong inducement for closely-held companies, whether owned in Canada or abroad, not

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		to go public. In addition, it is most unfair to the foreign owners of Canadian companies who, partly in response to incentives in our existing tax system, have heretofore sold shares to the Canadian public. 41. We believe that the combination of full integration and our recommended uniform treatment of all true capital gains will provide a strong incentive for investment in Canada by Canadians. 42. We are concerned about the implications of the proposed rule that a deemed realization would occur when a taxpayer gives up Canadian residence. We appreciate the necessity of preventing tax avoidance in this area but the full application of the rule would be unduly harsh in terms, for example, of business executives or technical employees who at the request of their employer move from one jurisdiction to another, or in terms of older persons who for health reasons have to retire to a warmer climate and who for the rest of their lives will need all the income they can generate from their savings to maintain a reasonable standard of living. We strongly recommend that this proposed rule be reconsidered. 43. Under the White Paper proposals inter vivos gifts will be treated for capital gains tax purposes as a sale at fair market value both from the point of view of the donor and donee but when gifts are made on death the heirs and beneficiaries of a deceased taxpayer will take over the assets of the deceased at the same cost basis as the deceased. Such cost basis would be increased by the death taxes (which should include Provincial succession duties) paid on the portion of the value of the assets in question that would, if then disposed of, be subject to the capital gains tax. To the extent, however, that any such assets are disposed of to pay estate duties or otherwise there will be both estate duties and capital gains tax payable on the difference between the aforementioned adjusted cost basis and the fair market value of the assets.

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		44. Under the estate and gift tax laws which were enacted as a result of budget resolutions introduced on October 26, 1968, property can be transferred between spouses either inter vivos or on death without any gift or estate tax. In addition, the new estate and gift tax laws provide for the integration of gift and estate tax. In view of the foregoing we recommend that: (a) inter vivos gifts between spouses be treated the same as the proposals in the White Paper for testamentary gifts, that is the donee take over the gifted property at the cost basis to the donor. (b) provision be made so that estate and capital gains tax will not overlap. One way of doing this would be for the estate tax to apply to the cost of the assets to the deceased and for the capital gains tax to apply to the difference between the fair market value and the aforementioned adjusted cost when disposed of.

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		Page 18, paragraph 72 of Brief 72. We are concerned about the proposals in the White Paper to tax non-residents on their Canadian property gains on the disposal of real property, shares of closely-held companies and shares of widely-held companies where the non-resident is selling out of a holding of 25% or more. The Carter Report recommended that Canada should not seek to tax non-residents on their Canadian property gains except those realized in connection with a business carried on in Canada. Since other countries of the World which impose a capital gains tax do not extend such tax to such an extent in its application to non-residents we think there will be considerable difficulty in negotiating amendments to the applicable tax treaties to permit the taxation of such gains. In addition if any such gains are to be taxed we think there is considerable merit in the argument that the rate imposed thereon should be the same as the withholding tax rate provided for in the Income Tax Act or applicable tax treaty.

Name: THE CANADIAN CHAMBER OF COMMERCE

Date Brief Received:

Principal Subject: Lower Rate of Tax on First $35,000

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The provisions of the present Income Tax Act respecting the lower rate of tax on the first $35,000 of taxable income were reviewed on page 3 of Special Study No. 5, entitled "Taxation of Small Businesses."	The proposals of the White Paper respecting the lower rate of tax on the first $35,000 of taxable income were reviewed on pages 3, 4 and 5 of Special Study No. 5, entitled "Taxation of Small Businesses."	Pages 13 and 14, paragraphs 45, 46 and 47 of the Brief. 45. The Council is of the view that it is important to encourage savings and growth and for that purpose there should be a special incentive granted to small businesses that require capital for expansion purposes. 46. The removal of the split rate of tax will mean withdrawal from a small incorporated business of relief from tax of up to $10,000 per annum. This benefit derived under the present system is not as generous as many believe it to be, particularly when funds are removed from the company, but as long as the funds remain in the company there is a valuable deferral which over a number of years becomes a sizeable amount. The proposal for full integration for closely held companies to some extent lessens the impact of the removal of the split rate. In addition for closely held companies with substantial non-taxable earnings the partnership election which to some extent can convert a tax deferral into a tax saving may be of considerable value. However, particularly when considered in conjunction with the capital gains tax, full integration and the partnership election are not sufficient offsets. 47. We are of the view that the tax system should continue to retain as an incentive for growth a benefit for small businesses.

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Date Brief Received:

Principal Subject: Employment & Child Care Expenses

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act makes no provision for the deduction of such expenses.	Employment Expenses: 1.32 The government has examined the deductions individuals may claim for various costs they incur, as well as differences in treatment between taxpayers who are employed and those who carry on a business or profession. The royal commission said many employees have been over-taxed because they have been denied the deduction of almost all expenses incurred in earning wages and salaries. But millions of taxpayers are involved, and a very wide range of expenses could be related to earning their employment income. These taxpayers do not keep detailed records. The government has found no practical way to permit employees to deduct actual costs as do those carrying on a profession or other business. We propose to provide employees with a general deduction to cover expenses, in addition to certain specified deductions. The amount would be 3 per cent of employment income, up to a total of $150 a year. This could benefit more than 6,500,000 persons, the great majority of them earning less than $10,000 a year.	Page 14, paragraphs 48 of the Brief 49. We applaud the proposals to provide a deduction for employement expenses and child care expenses for income earning parents and capital cost allowance for costs which previously were neither deductible or depreciable. These reforms are long past due and probably contribute as much to fundamental fairness in the tax system as any other of the proposals.

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	2.12 As its second measure, the government proposes to make more provision in the law for the expenses legitimately incurred in earning wages or salaries. However, it has reached the conclusion that claims for expenses on the broad basis suggested by the commission would either impose record-keeping on millions of employees or deny them the ability to submit acceptable claims. It would also produce an impossible processing task in tax administration with inevitable long delays in making refunds. Consequently the government proposes that general limits be retained on expenses that can be deducted from employment income but that a general deduction be provided and somewhat greater recognition given to special situations where employees have to live for a period of time at a work site away from home. 2.13 It is proposed to allow a general deduction for employment expenses, similar to the option proposed by the commission but with a lower maximum. The government believes these expenses are not generally as high as implied by the commission. It would be costly, and inequitable to others, to permit substantially more to be deducted by means of a formula than was normal in typical cases. Consequently it is proposed that the general deduction allowed for expenses incurred in earning employment income be 3 per cent of gross employment income up to a maximum of $150 per year.	

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	Child Care Expenses 1.33 Costs of looking after young children when both parents are working, or when there is only one parent and that parent is working, would be allowed as a deduction subject to certain conditions. This new plan is intended primarily to benefit mothers who need to work to support their families, and would be in addition to the normal exemption for children. The maximum expenses allowed would be the lower of $500 per child under age 14 or $2,000 per family. 2.7 We propose to permit deduction of the child care expenses that face many working parents today. The problem of adequately caring for children when both parents are working, or when there is only one parent in the family and she or he is working, is both a personal and a social one. We consider it desirable on social as well as economic grounds to permit a tax deduction for child care expenses, under carefully controlled terms, in addition to the general deduction for children.	

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	2.8 Costs to be deducted would include baby-sitting expenses, day nursery care and, up to $15 a week, lodging paid at boarding schools and camps. Amounts would be deductible up to $500 per child under the age of 14, or $2,000 per family. The total allowed would also be no more than two-thirds of the earned income of the parent with the lower earned income; it would be necessary to ensure that in fact there is not a parent at home. Deductions would have to be supported by receipts and could not be claimed for payments for care of a child by a person claimed by a taxpayer or the taxpayer's spouse as a dependent relative.	

Name: THE CANADIAN CHAMBER OF COMMERCE

Date Brief Received:

Principal Subject: Business Promotion Expenses

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The Income Tax Act and existing assessing practices recognize that reasonable amounts of business promotion expenses are proper deductions in computing income that is subject to tax. Section 12-2 of the Income Tax Act authorizes the tax collector to refuse to recognize unreasonable large sums expended for this or any other purpose.	5.9 Although the government believes that provision should be made for the deduction of legitimate business expenses that have not previously been deductible, it also believes that the present system permits deduction of certain types of expenses which taxpayers should be expected to meet out of tax-paid income. Consequently it is proposed that the Income Tax Act specifically deny deduction for entertainment expenses, the costs of attending or sending employees to conventions, and the cost of dues for membership in social or recreational clubs. This provision would not prohibit the expenditure of funds for these purposes, but it would ensure that taxpayers who wish to make such expenditures would do so out of after-tax dollars. 5.10 Under the system outlined in Chapter 4, whereby shareholders are given credit for the tax paid by their corporations, merely denying a deduction for this type of expenditure is not sufficient. Although the denial of the deduction would mean that the corporation pays extra tax, the shareholders of the corporation would receive credit for the extra tax paid. Therefore, it is necessary to provide further that, in the case of corporate taxpayers, taxes due because of the non-deductibility of these expenditures would not be creditable.	Page 14, paragraphs 50 and 51 of the Brief 50. The proposals not to allow any deductions for so-called entertainment expenses and the expense of attending conferences associated with one's business or employment are indefensible in principle and constitute a discrimination between business pratices. We agree that the taxpayer should be put to strict proof that such expenditures were reasonable and laid out for the purpose of earning income from his business, profession or employment, and were not personal expenses. If he is able to meet such a test, there is no valid reason he should not be allowed them as deductions in computing his income. 51. We would also point out that for many small businessmen, "entertaining" clients or customers at lunch or dinner is the only way they can effectively advertise their goods or services. Ordinary type advertising campaingns are beyond their means, and, where a business is of the type that depends on only a few customers, the usual type of advertising may be ineffective.

Name: THE CANADIAN CHAMBER OF COMMERCE

Date Brief Received:

Principal Subject: Pension & Retirement Savings Plans

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act contains no provisions respecting investments of pension plans. Assessing practices and rules respecting pension plan investments were set out in a publication dated October 1, 1968. Generally these require 90% of funds be invested in Canadian securities and prohibit investment in the company's own securities.	2.51 Most pension funds now are subject to regulation under the Pension Benefits Standards Acts of the provinces or of Canada. These control the investments of pension funds in a manner generally adequate for tax purposes. However, it is essential to be sure that tax-free funds cannot be diverted through investment in such a way as to bring current benefits to those who contribute to them and control them, and to provide sanctions to be applied when investments are made contrary to the rules. With adjustment to meet these two points it is proposed that the rules applying to invesment of pension funds be the same as under the provincial and federal laws respecting pension plans. For registered retirement savings plans the permitted range of investments could be somewhat broader.	Pages 14 and 15, paragraphs 52, 53, 54 and 55 of the Brief 52. The Executive Council concurs in the statement that it is in the national interest to encourage personal savings plans for retirement on an equitable basis for all Canadians, recognizing particularity the growing importance of such pools of capital for investment in Canada's growth. Our concern is with the implications of a still more stringent limitation on the freedom of such funds to invest in securities of foreign corporations 53. Canada's development in recent years, particularly into the technologically intensive industries, has been increasingly through subsidiaries of foreign corporations which, in turn, obtain most of their technology from their parent companies. In some cases, these subsidiaries have issued shares to the public; in many cases they are wholly owned. Because Canada needs such industries if she is to make the fullest use of her resources, they should be encouraged to locate here, but incentives to operate in Canada may be greatest if they are wholly owned. 54. It is thus inevitable that Canadian investors, such as pension fund trustees who must maintain balanced portfolios in which the best protection calls for investment in the most dynamic industries, will find it impossible to buy Canadian securities to meet these objectives without bidding up the price of the very limited supply. There will not be enough Canadian stocks available in dynamic growth companies covering a wide spectrum of industry to meet the needs of our institutional and individual investors. Thus, to insist that 90% of the investments of such funds must be invested in whatever Canadian securities may be available is to risk endangering the security of pension funds and to push up the cost of Canadian securities unnecessarily. 55. It should be recognized that the foreign parent company is investing substantial sums in Canada. Therefore it is submitted that the rules limiting pension funds investments should classify as Canadian securities shares in a foreign parent company which has substantial operations in Canada, and which lists its shares on a Canadian exchange.

Name: THE CANADIAN CHAMBER OF COMMERCE

Date Brief Received:

Principal Subject: Extractive Industries

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		Page 15, paragraphs 56 and 57 of the Brief **56.** The Executive Council welcomes the government's statements in the White Paper which indicate a recognition of the need for special incentives for resouce industries. It does not believe it can make a specific contribution to the debate about the form and extent which these incentives should take. The Executive Council supports, however, the resource industries' position that the incentives should be designed to encourage the exploration for and development of Canada's resources. The White Paper proposals include sharp reductions in incentives for minerals' and other resources' exploration and development, and we must constantly keep in mind that we are in competition for such exploration and development with other countries. We regard the benefit of such activities to all Canadians as far outweighing losses of neutrality, equity, or tax revenue which these incentives represent. Reduction in activity by the mining or petroleum industries would be detrimental to Canada's economy as a whole, and result in disproportionate detriment for specific regions in Canada whose economies depend on vigorous mining and petroleum industry activity. **57.** We note with approval the provisions proposed in the White Paper to enable people whose main business is not in the resource industries, to participate more fully in these worthwhile ventures.

Name: THE CANADIAN CHAMBER OF COMMERCE

Date Brief Received:

Principal Subject: Electric, Gas and Steam Utilities

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		Pages 15 and 16, paragraphs 58 and 59 of the Brief 58. Since the introduction of the White Paper, the Minister of Finance has announced some changes with respect to credit for corporate tax on dividends from utility companies, the regular corporate tax from which is paid through to the provinces by the federal government. We appreciate this is a very difficult question to deal with particularly where in some parts of Canada the tax is rebated right back to the Company and back through to the customers where in other provinces the tax dollar is stopped in the provincial treasury. We regard this as essentially a matter as between the federal and provincial governements and inter-governmental transfers. Regardless of what happens to the corporate tax on these companies after it leaves the companies, we feel that the shareholders should be treated in all respects in the same manner as shareholders of other Canadian companies and credit given against personal tax for the amount of tax initially paid. 59. Not to do this results in another distortion of individual investment decisions which tends to negate some of the more desirable features of the tax reform proposals.

Name: THE CANADIAN CHAMBER OF COMMERCE

Date Brief Received:

Principal Subject: Co-Operatives and Credit Unions

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		Page 16, paragraph 60 of the Brief **60.** The Canadian Chamber has long protested what it considers to be an unfair tax advantage extended to co-operatives and credit unions which compete directly with corporations subject to full tax on corporate earnings. We therefore repeat from the 1969-70 Chamber Statement of Policy that "we urge that in taxation matters a co-operative should be treated like an ordinary corporation".

Name: THE CANADIAN CHAMBER OF COMMERCE

Date Brief Received:

Principal Subject: Averaging of Income

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The Income Tax Act only permits farmers and fishermen to average income.	2.53 Income tax is levied on a year's income at a time, at a rate that normally depends on the size of that year's income alone. But some types of income are irregular, and tax must be paid at a higher rate in a year when income is abnormally high. This may cause taxpayers with irregular or varying incomes to pay significantly higher taxes over a series of years than those whose incomes are more regular. Special provisions in the existing law permit farmers and fishermen to average their incomes over a block of five years, authors over three years, and businessmen on certain unusual types of income over three or five years. Certain types of single payments out of pension funds, or by employers on retirement of an employee, can be taxed at the average rate of tax paid by the employee over the preceding three years.	Page 16, paragraph 61 of the Brief 61. The Executive Council welcomes the White Paper proposal to permit some averaging of income for all taxpayers, but the system proposed does seem to be unnecessarily restrictive, and we recommend that the proposals be revised to provide a real measure of relief.

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	2.54 The introduction of a capital gains tax, particularly one in which accrued gains on shares in widely-held Canadian corporations are taxed periodically, would increase the need for a more general averaging formula, because many more taxpayers will occasionally have incomes much higher than their average incomes. The royal commission noted this need under a capital gains tax and recommended for all taxpayers an averaging formula similar to that now available to farmers. It also recommended that "deposit averaging" be permitted, under which a taxpayer could deposit with the government a portion of his income—on an interest-free basis—and pay no tax on it until it was withdrawn.	

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	2.55 The government has reached the view that a general averaging formula should be available to all individual taxpayers. However, it proposes a much simpler and more automatic system than the royal commission did. Averaging would introduce new complications for the taxpayer, and new need for keeping records. Moreover, the system proposed by the commission would confront the taxpayer with difficult choices, and the possibility of choosing a period that would later prove to be against his own interest. The proposed simpler method can be applied automatically by the central tax assessment computer, using the information for previous years stored in its memory. Moreover, it would work smoothly and fairly even when tax rates change. It should also be noted that averaging options can be very expensive in terms of revenue, particularly at a time when incomes are growing rapidly, and there must be safeguards against giving the benefits of averaging to what are simply growing incomes.	

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	2.56 The method proposed is as follows: when the income in the taxation year exceeds the average of the taxpayer's income in the preceding four years by more than one-third, the excess income would be taxed as though it were subject to a graduated rate schedule in which the income brackets to which each rate applied were five times as wide as normal. The formula is necessarily complicated but this would not concern taxpayers because it can be applied on their behalf. Tables 11 and 12 show the application of the formula in more detail. 2.58 It would not be possible to bring the general averaging arrangement into effect immediately. It would be necessary to have the records of assessed income for previous years for all or nearly all taxpayers before the system could be fairly used. Until this accumulation of information reaches five years it would be necessary to use a shorter series of years, with a lower "threshold level".	

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Principal Subject: Rate Structure

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		Page 16, paragraphs 62, 63 and 64 of the Brief 62. The government has, for estimating the impact of the tax reform proposals, resources, and access to information, unmatched in the private sector. The governement therefore carries a heavy burden of care not to underestimate the adverse nor to overestimate the beneficial impact of the proposals in efforts to achieve greater equity. 63. As indicated in the first part of this Brief, under National Objectives, we think it is most important to lighten the proposed tax load of the middle income group as much as possible since in this area there is a great potential for savings and therefore economic growth. In this connection, the Executive Council is strongly of the view that substantial increases in taxes should not be incorporated in a tax reform programme and that the new tax system should be designed to raise approximately the same revenue as the present system both initially and over the implementation period and thereafter. This, for example, could be done by providing in the tax legislation for future increases in the levels at which the rate is stepped up and in particular the "cut-in" point of the maximum rate could be increased from $24,000. 64. We also note that the existence of a top rate of tax of around 50% might offset some of the disincentive effects of the higher rates at income levels below $24,000. This effect would result from the fact that a person would know that there would at least be a reasonably realizable end to rate increase if his endeavours brought him higher income. We, therefore, regard it as essential that the approxiamte 50% maximum rate become the cornerstone of Canada's future tax system.

Name: THE CANADIAN CHAMBER OF COMMERCE

Date Brief Received:

Principal Subject: Foreign Source Income

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The present Income Tax Act contains no such concept.	1.47 There would be some changes in the taxation of income earned by Canadian residents and corporations from sources outside Canada to prevent "tax havens" being used to evade Canadian taxes. Individuals would continue to pay Canadian taxes on investment and other income from sources outside Canada. They would receive a credit for the withholding tax or other income tax paid directly to governments of other countries. Corporations would also receive such credits except when income is from a controlled foreign corporation.	Pages 17 and 18, paragraphs 65, 66, 67, 68, 69 and 70 of the Brief **65.** We applaud the proposals in the White Paper to put a greater emphasis on the negotiation of tax treaties with foreign countries and the recognition of the source country with which Canada has a tax treaty as the taxing country by means of the proposal in such a case to permit "controlled" foreign corporations to flow dividends back to Canada tax free. We are also in favour of any reasonable provisions that may be required to prevent income which would normally be generated in Canada from being diverted to tax haven jurisdistions. **66.** We point out, however, that tax havens are sometimes used by Canadian corporations in order to reduce income taxes otherwise payable to foreign jurisdictions rather than as a means of diverting what would otherwise be Canadian source income to foreign jurisdictions, and that Canadian exports have increased because such an advantage is available. This is a recognized method of operating in international trading circles, and is understood by foreign governments involved as a proper mechanism to assist the development of business within their jurisdiction. The denial of such a right to Canadian corporations could place them at a serious net disadvantage opposite foreign companies, and could damage Canada's export trade. In this connection, it is our understanding that the provisions in Sub-paragraph F of the U.S. Internal Revenue Code (which the White Paper proposes to pattern amendments on) are extremely complex and go beyond what is required for Canada to prevent abuses. A U.S. government official stated recently that this provision "is too complex for efficient administration" and that "complexity is very difficult to avoid, but we consider simplification an important goal and intend to weigh it heavily in the process of developing our proposals". **67.** In view of the foregoing, we recommend that amendments patterned on Sub-paragraph F not be proceeded with and that the existing provisions of the law be enforced to prevent the diversion to tax havens of income that would normally be generated in Canada.

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Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	1.48 New distinctions between classes of foreign corporations controlled from Canada are outlined in Chapter 6 and will be further elaborated in supplementary papers. Unless tax treaties provide otherwise, Canadian corporations would be taxed on dividends received from foreign corporations in which they have a substantial interest. However, they would receive credit for the withholding taxes levied on the dividend by the foreign country, and for the corporation tax paid by the foreign corporation on the profits from which the dividend was paid. Tax treaties would maintain the exemptions for dividends received from foreign corporations more than 25-per-cent-owned by the recipient Canadian corporation, and carrying on bona fide active business operations in the foreign country. Other provisions patterned generally on the United States law would impose full Canadian taxes on corporate income accruing in "tax-haven" operations. Various other detailed safeguards would be introduced to keep to a minimum the use of non-resident corporations to reduce Canadian taxes of Canadian residents.	68. We note that the existing Section 28 (1) (d) dividend exemption is to be retained for several years, at least through 1973, as a transitional measure until an appropriate network of international tax treaties can be negotiated. Under the White Paper proposals, after the transitional cut-off date dividends from countries with which Canada does not have a tax treaty will be subject to a gross up and credit system for source country taxes. If Canada should prove unsuccessful in negotiating treaties with a substantial number of foreign countries, particularly with developing countries, then we are concerned about the implications of the gross up and credit system. First if bona fide business income is in fact taxed at a lower rate in the source country with which Canada does not have a tax treaty this will create pressure to avoid bringing the after tax earnings from such source country back to Canada (which we do not think is desirable) and may also result in the source country imposing a level of tax at least equal to the Canadian level to avoid the difference being sponged up by Canada. This problem may be particularly serious when the source country is a developing country where it is the World's interest to encourage development through the use of private capital and where the developing country may grant tax concessions to encourage foreign investment. Accordingly we recommend that: 69. (i) if Canada is unable to negotiate a broad network of tax treaties then the matter be reconsidered. We can see no great reason for not recognizing the source country as the sole taxing country where Canada does not have a tax treaty as long as potential abuses are adequately dealt with. 70. (ii) in any event, to the extent that treaties cannot be negotiated with developing countries, a procedure be established with appropriate safeguards to prevent tax avoidance, whereby a country could be designated as a developing country which would permit free flow back of dividends on the same basis as would be the case if Canada had a tax treaty with such country.

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	6.11 The system by which the government proposes to attain its objectives is set out in the following paragraphs. These paragraphs deal successively with dividends from controlled foreign corporations, passive income of controlled foreign corporations, other foreign investment income, business profits and salaries and wages earned abroad by Canadians, and a new procedure for giving shareholders of Canadian corporations credit for the foreign withholding taxes paid by their corporations. 6.15 The government has concluded that neither of these systems is either "right" or "wrong". It proposes to continue in a restricted form the present exemption of dividends received by a Canadian corporation from a controlled foreign corporation. For this purpose, the Canadian corporation would be assumed to control the foreign corporation if it owns 25 per cent or more of the voting shares of the foreign corporation. The first restriction proposed is that the exemption privilege would be extended only to dividends from those countries with which we have concluded bilateral tax treaties. A second is that the effect of the exemption would be eliminated for certain types of diverted income by the proposals described below under the heading "Passive Income of Controlled Foreign Corporations." These restrictions are necessary to frustrate efforts to use the dividend exemption to reduce artificially the tax burden on tax-haven income.	

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	6.17 A dividend from a Canadian-controlled foreign corporation not protected by tax treaty would be subject to a tax-credit regime. The Canadian corporation would be allowed a credit for the foreign withholding taxes imposed on the dividend and for any foreign corporate tax imposed on the underlying business profits from which the dividend was paid. This would reduce or eliminate taxes due on the dividend, which taxes would be computed on the dividend plus the tax for which credit was available. 6.18 The existing dividend exemption system would be retained for several years, at least through 1973, as a transitional measure until an appropriate network of international tax treaties can be built up.	

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	6.19 Subject to the limitation noted below, the general capital gains provisions would apply to the shares of controlled foreign corporations—gains realized on the disposal of them would be fully taxable and losses fully deductible (except of course to the extent that the gain or loss accrue prior to valuation day). However, because full corporate tax would not be collected on dividends from such corporations it would be necessary to place a limit on the deductibility of losses if the system as a whole is to be effective. Otherwise, Canadian corporations could purchase control of foreign corporations, arrange to receive most of the assets of the company as a special dividend, and then sell the shares for the value of the remaining assets. The dividend would bear little or no Canadian tax because of the foreign tax credit or the exemption, but the loss would reduce taxable income and save Canadian tax. This tax result is clearly inappropriate since the Canadian corporation would not, in fact, have suffered an over-all loss on its investment. To avoid this consequence, it is proposed to reduce the deductible loss on such shares by reference to the dividends received from the corporation that did not bear full Canadian corporation tax.	

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	6.20 As noted above, the exemption privilege is susceptible to abuse. Not all foreign corporations carry on bona fide business operations. Some are merely devices of convenience to which income from other sources—dividends, interest, royalties and trans-shipment profits—may easily be diverted. The dividend exemption system would permit such income to be brought back to Canada tax-free. Even the tax-credit system would permit the Canadian tax on such income to be postponed indefinitely. 6.21 To counter this type of tax-haven abuse, the United States now provides that when such income is channelled to a controlled foreign corporation, the U.S. controlling shareholders shall be taxed on a current basis whether or not the income is distributed to them. U.S. taxes are levied in the year in which the profits are earned rather than postponed until the profits are returned home. The government proposes to introduce provisions patterned generally on those in the United States. This proposal involves complicated and difficult law, but the problem is serious and defies easy solution.	

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	6.23 The present tax treatment of the business profits and wages earned abroad by Canadian corporations or individuals is the same as that for portfolio investment income. The income is taxed as earned, and the taxpayer is entitled to a foreign tax credit for taxes paid to the government of the foreign country on that income. The government proposes to continue that treatment.	
	6.24 While the government proposes to retain the existing system of taxing foreign business profits, two important changes to the foreign tax-credit provisions are appropriate. Provisions will be put forward to prevent taxpayers from reducing Canadian tax by transferring the operation of a foreign branch which has sustained losses to a foreign company in order to avoid the Canadian tax which should ordinarily be recaptured on subsequent branch profits.	
	6.25 In addition, the government proposes to amend the foreign tax-credit provisions to permit the excess of foreign taxes paid over the amount creditable in a year to qualify for allowance in other years. The carry-over of the foreign tax credit is intended to alleviate the problem that arises when income is taxable abroad in a different year from that in which it is taxable in Canada.	

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	6.26 In its tax treaties, Canada will also be prepared to recognize the income taxes levied by political subdivisions of foreign countries on a reciprocal basis. If the foreign country is prepared to give a foreign tax credit for the income taxes levied by the provinces, Canada will agree to give a credit or a deduction, whichever is appropriate, for the taxes levied by its political subdivisions.	

Name: THE CANADIAN CHAMBER OF COMMERCE

Date Brief Received:

Principal Subject: Non-Resident Owned Investment Companies

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 70 of the Income Tax Act This section permits an investment company that meets certain tests to elect to pay a tax of 15% on its annual taxable income, that includes dividends from Canadian companies. No further Canadian tax is imposed when such a company pays dividends or interest to non-residents of Canada. Foreign income taxes paid by such a company are allowed as an expense only, and are not a deduction from the 15% Canadian tax.	6.40 The proposed increase in withholding tax rates has implications for that category of corporation known as a "non-resident-owned investment corporation"; an entity taxed at 15 per cent on investment income but exempt from the obligation to withhold tax from distributions abroad. Such companies, while resident in Canada, are generally treated for tax purposes as non-resident persons. They constitute a convenient holding device for foreign investors in Canadian securities. The tax on such companies would be increased to match the rate of the non-resident withholding tax.	Page 18, paragraph 71 of the Brief 71. We note that paragraph 6.40 ot the White Paper proposes that the tax rate for non-resident owned investment corporations would be increased to match the proposed 25% rate of the non-resident with-holding tax. The non-resident owned investment corporation has been a useful vehicle for investment in Canada and should not be discouraged. The Executive Council is of the view therefore, that the non-resident owned investment corporation rate should follow the treaty rate if the non-resident owners are resident in a country with which Canada has a treaty. We appreciate the potential for abuse in this area but such abuse could be largely overcome by providing that the treaty rate is only applicable if prescribed information which is satisfactory to the Minister is submitted to establish that all of the non-resident owners are resident in the applicable country with which Canada has a treaty.

APPENDIX "G"

THE PRINCE GEORGE CHAMBER OF COMMERCE

COPY OF A

PRESENTATION TO THE HOUSE OF COMMONS COMMITTEE ON FINANCE, TRADE AND ECONOMIC AFFAIRS ON THE WHITE PAPER ON TAX REFORM

PREAMBLE:

While we are generally in favour of the Government's attempt to reform our present tax system to broaden the tax base and achieve a fairer and more equitable tax system, we have serious objections to some of the White Paper proposals as set out below.

We hope that the Government has made thorough and comprehensive studies to determine that the proposals will not adversely affect:

(a) economic growth,

(b) incentive to work and take risks,

(c) savings and investments by the private sector,

(d) foreign investment in Canada required for further industrial development, and

(e) needed increases in employment opportunities.

Should the tax collected under the new proposals exceed the anticipated revenues, we strongly request that the personal income tax rates be reduced particularly in those brackets of taxable income, which will bear the brunt of the proposed tax increases.

OBJECTIONS TO WHITE PAPER PROPOSALS:

1. Elimination of Low Corporate Tax Rate Without Compensating Incentive

Small businesses will be harder hit than big corporations by the proposed elimination of the low tax rate of 21% on the first $35,000 of corporate income. The proposal will mean that up to $10,000 in additional taxes will have to be paid each year. It is already hard for small businesses to raise

1. Elimination of Low Corporate Tax Rate, etc. - Cont'd.

capital to finance growth and expansion. We need small businesses in Canada. We should keep in mind that all big corporations have grown out of small corporations.

Therefore, we strongly urge you to provide some compensation for small businesses in the form of accelerated depreciation such as the Carter Report recommended or some system of tax deferral during the first 5 or 10 years of operation or an investment incentive credit.

We feel, however, that the present system should be retained.

2. Taxing of Capital Gains

While not approving of the proposals to tax capital gains at full personal tax rates we appreciate that it may have to be done to broaden the tax base and to avoid the present problems caused by the distinction between trading or income gains and capital gains.

However, if capital gains are to be subject to tax, we suggest that they be taxed at full personal tax rates only within the first 5 years of acquisition. Likewise all capital losses should be deductible. This would offset the effects of inflation.

3. Taxing of Capital Gains of Residences and Personal Chattels

The proposal to tax gains made on sale of personal residences and personal chattels will only irritate and upset the taxpayers. The effect of the proposal will be an enormous amount of record keeping by both the taxpayers and the Tax

3. Taxing of Capital Gains of Residences, etc. - Cont'd.

Department. In our opinion our self-assessing system will have its most serious test in this area should this proposal become law.

The effect of inflation in producing a "paper-profit" which would be taxable under the proposal also speaks against it.

Consequently, we strongly object to this proposal.

4. Revaluation of Widely-Held Shares Every 5 Years

We strongly oppose the proposal that shares in widely-held corporations be revalued every 5 years and that one-half of such gains or losses be subject to tax. The effect of this proposal would be to make "paper-profits" subject to tax before an actual gain would have been realized by sale of the shares. We disapprove of the "deemed realization" concept in this proposal.

5. Disallowance of Convention and Entertainment Expenses

We object to the proposal to disallow all convention and entertainment expenses. Conventions are necessary for businessmen and professional men to meet and keep up with the latest developments in their businesses. Such opportunities to meet should not be denied in the interest of economic growth and development.

Entertainment and business promotion expenses are vital to the operation of a business. Some enterprises advertise heavily to obtain business, others must use personal contacts as a means of obtaining new and retaining old business. Consequently it would be grossly unfair to certain enterprises to disallow all entertainment and business promotion expenses.

5. Disallowance of Convention and Entertainment Expenses - Cont'd.

The present law can be enforced to achieve the desirable objectives of reducing so called "expense account living" whenever it is abused.

6. Income Averaging

The proposal for income averaging is commendable. However we feel that the method proposed is too restrictive to achieve a true averaging of income, particularly in view of the proposal to make capital gains subject to tax.

7. Losses on Rental Property

It is proposed that losses on rental property caused by a deduction of (a) interest, (b) property taxes, and (c) depreciation (capital cost allowances) be disallowed. As interest and property taxes are direct operating expenses they should, in our opinion, be allowed as should depreciation.

We feel that depreciation should be allowed even if it would result in a net rental loss because capital will be continually needed to build much needed apartment blocks all across Canada.

Our suggestions would mean that not all incentives including a non-taxable capital gain on sale under present laws for investors to invest their money in apartment blocks would be taken away. Our suggestions would also reduce the natural tendency of the landlords to increase rents (which would be inflationary) to keep the already low investment return on its present level should the White Paper proposals become law.

8. Review of Present Estate and Gift Taxes

As a consequence of our recommendation to delete the proposal to revalue shares in widely-held corporations every 5 years (point 4), the Government may consider that there should be a deemed realization upon death. If so, the estate would be subject to (a) tax on capital gains (one-half in many cases) at full personal rates, and (b) the present stiff estate taxes and death duties. Because of this combined heavy tax burden we suggest that the present high estate and gift tax rates be reviewed and reduced so that the combined taxes on death would not be confiscatory.

9. Mining Industry

Mining in Northwestern British Columbia is just commencing to move, as compared to that of Ontario for instance. There are several developments of substantial size which will have qualified in time to avail themselves of the provisions for depletion of reserves and tax incentives. However, there are many exceptionally large mining properties which could suffer severe set backs in their financing and development plans under the provisions of the proposals in respect to tax incentives and depletion of reserves, and the result would be a staggering blow to Northern development as envisaged by the Federal and Provincial Governments. Undoubtedly, the same situation would exist throughout all of the Mid-Canada Corridor and North.

APPENDIX "H"

BRIEF

of the

CANADIAN DENTAL ASSOCIATION

commenting on the

GOVERNMENT of CANADA'S WHITE PAPER

"PROPOSALS for TAX REFORM"

April, 1970

APPEARING FOR THE CANADIAN DENTAL ASSOCIATION AT THE PUBLIC HEARINGS OF THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE, APRIL 15, 1970:

Dr. W. J. Spence, Toronto, Ontario, President-elect;

Dr. Henri Brouillet, Montreal, Quebec, Past President;

Dr. H. N. Beach, Ottawa, Chairman of the Sub-Committee on Taxation;

Dr. W. G. McIntosh, Toronto, Ontario, Executive Director;

Mr. M. L. O'Brien, Toronto, Ontario, Lawyer.

CANADIAN DENTAL ASSOCIATION

The Canadian Dental Association is the national organization of the dental profession in Canada.

Ten provincial dental organizations are corporate members of the Association. They are:

College of Dental Surgeons of British Columbia;
Alberta Dental Association;
College of Dental Surgeons of Saskatchewan;
Manitoba Dental Association;
Ontario Dental Association;
Collège des Chirurgiens Dentistes de la Province de Québec;
New Brunswick Dental Society;
Nova Scotia Dental Association;
Dental Association of Prince Edward Island;
Newfoundland Dental Association.

Individual members are licensed dentists whose names have been submitted by corporate members. The membership of the Canadian Dental Association thus includes virtually all practising dentists in Canada. The Association has 7,000 individual members of whom 1,200 are French-speaking, plus 300 honorary and associate members.

SUMMARY OF RECOMMENDATIONS

Subject	Recommendation	Paragraph
Accrual Basis of Accounting	The cash basis accounting method permitted to dentists under present law should be retained.	1.3
Educational Expenses	• Tuition fees for graduate and post-graduate programmes and continuing education courses recognized by provincial licensing bodies should be allowed as a deduction whether the course is taken inside or outside Canada.	2.3(a)
	• The option of the deduction of tuition fees should be granted in the first instance to the student, and if not taken by him, then to the person actually making the payment.	2.3(a)
	• If the tuition fee deduction cannot be utilized, the student should be permitted to carry the tuition fee costs forward against future income.	2.3(a)
	• The cost of books and/or dental supplies used in graduate, post-graduate and continuing education programmes should be deductible, and if this deduction is not utilized, it may be carried forward against future years' income.	2.3(b)
	• Travelling and lodging expenses to attend graduate, post-graduate or continuing education programmes should be deductible, and if the deduction is not utilized, the taxpayer should be permitted to carry the expense forward against future years' income.	2.3(c)

Subject	Recommendation	Paragraph
	• Expenses incurred by a dentist in belonging to a study club recognized by a dental licensing body or university should be deductible.	2.4
	• The present deduction of convention expenses should be retained provided that the expenses are reasonable in the circumstances.	2.5
	• The incentive created by non-taxation of bursaries and fellowships should be retained.	2.6(a)
	• If fellowships, bursaries and research grants are to be taxed, then the travelling, lodging and other expenses incurred by the taxpayer in utilizing such a grant should be deductible.	2.6(b)
	• The incentives provided by exempting professors and teachers from foreign lands from Canadian income tax for two years should be retained.	2.7
Medical Expenses	The 3% qualification limit for medical expenses should be reduced in order to facilitate deduction of dental and other health expenses by taxpayers in all income brackets.	3.1
Personal Exemptions	A flat amount creditable against tax payable should be established rather than increasing exemptions.	4.3
Income Averaging	• All taxpayers should be permitted to average their incomes on the same basis or, in the alternative, taxpayers should be permitted to make	5.(a)

Subject	Recommendation	Paragraph
	payments into registered retirement savings plans in the same manner as authors and professional athletes.	
	• A dentist should be permitted to carry forward his educational expenses against future years' income.	5.(b)
United States-Canada Tax	A full review should be made of the tax burdens proposed on middle income taxpayers in the United States and Canada in order to avoid the loss of qualified dentists to the United States for tax reasons.	6.
Family Unit	If the family unit concept is to be reconsidered, the Government should consider the implementation of a joint return filing by husband and wife such as is in effect in the United States.	7.
Child Expenses	No arbitrary limits should be imposed and the amount of such deductions be generally limited by a consideration of the reasonableness of the expenses when compared to the amount of income earned by the wife.	8.
Expenses	• Section 21(2) of the Income Tax Act which denies the proprietor or partner in an unincorporated business to deduct remuneration paid to his spouse should be repealed.	9.1
	• Entertainment expenses should be allowed as a deduction provided they are reasonable in the circumstances.	9.2

Subject	Recommendation	Paragraph
	• The maximum deduction of $150 for employment expenses should be revised to permit a claim in excess of $150, provided detailed records are maintained.	9.3
	• Moving expenses of dentists should be deductible.	9.4
	• The proposal to prohibit the deduction from other income of a loss resulting from the ownership of rental property should not apply where the loss occurs from the ownership of rental property in which the landlord carries on business.	9.5
Retirement - Pension Plans and Retirement Savings Plans	• Consideration should be given to increasing the existing limits on contributions to pension plans.	10.1
	• The maximum contribution permitted by a self-employed person should be equal to the maximum allowed for the combined contributions of an employee and employer.	10.1
	• The refund of corporation tax paid by a company from which dividends are received by a pension plan should be granted to pension plans and registered retirement savings plans.	10.2
	• The present flat 15% rate of tax on death benefits paid out of pension plans or registered retirement savings plans should be retained.	10.3
Capital Gains	• A capital gain derived from the sale of a principal residence should not be taxed.	11.1(a)

Subject	Recommendation	Paragraph
	• In the alternative, there should be a complete rollover if a new residence is purchased within a reasonable time of the sale.	11.1(b)
	• Dentists who move on a temporary basis to an area outside Canada should be entitled to elect to continue as Canadian residents with a complete rollover.	11.1(c)
	• In the alternative, a dentist who moves to a new area to establish a practice or to study should be permitted a complete rollover exemption.	11.1(d)
	• In the alternative, the exemption per year of occupancy should be related to the value of the house when purchased.	11.1(e)
	• A taxpayer who leaves Canada should be given an election to continue as a Canadian resident and thereby avoid tax on the deemed realized capital gain.	11.2
	• The value of goodwill of a dental practice on valuation day should be excluded from tax and only the difference between the amount of proceeds received for goodwill on the sale and the value on valuation day should be subject to the capital gains' tax.	11.3
Corporations and Their Shareholders	There should be no difference in the taxation of income from investments in closely held companies as opposed to widely held companies.	12.

Subject	Recommendation	Paragraph
Gifts and Bequests	Either the estate tax or the income tax on capital gains should be applied and not both taxes.	13.
Investment Income of Clubs and Other Non-Profit Organizations	The investment income of associations such as the Canadian Dental Association should not be subject to corporation tax.	14.

INTRODUCTION

On November 7, 1969 the Honourable E. J. Benson, Minister of Finance, released a White Paper outlining the Government of Canada's "major proposals for reform of the income tax structure". The Government has welcomed public discussion of the proposals and indicates in the White Paper that "The government believes that taxpayers and those who represent them in Parliament and in provincial legislatures should contribute actively at an early stage to the formulation of policies that so directly and vitally affect them."[1] In addition, the Minister of Finance has on numerous occasions invited comments and "constructive" criticism on the proposals.

In this brief, the Canadian Dental Association is answering the Minister's request by setting forth its comments. In preparing the brief, the Association recognizes that it acts on behalf of the dental profession as a profession and also on behalf of the dentists as taxpayers. With this thought in mind, the following comments are submitted not only in relation to the effect of the proposals on the profession and on individual dentists as taxpayers, but on the quality and availability of dental services for Canadians.

It is the Association's position that the implementation

(1) Hon. E. J. Benson, Minister of Finance, Proposals for Tax Reform, 1969, p.5

of the White Paper proposals will have a detrimental effect on the dental profession. Dentists will face increasing taxes - with no allowances for educational expenses incurred either before or after graduation - and payment of tax when cash is not available. They will be required to revalue their shares in widely held Canadian corporations every five years and include for tax purposes in that year any resulting gain.

The Association has no objection to equitable tax reform but believes that the dentist should have the same opportunities to provide for his future as does the senior civil servant or executive of a corporation. Today, these employees are retiring with annual pensions of $15,000 or more. A dentist must provide for his own fringe benefits and security, and for him to purchase a guaranteed annuity of $15,000 requires a substantial outlay which he must pay out of "after tax" income (aside from the annual maximum which can be paid into a registered retirement savings plan).

The effect of the proposals, particularly that of revaluation, will make it difficult for a dentist to accumulate the funds he needs to provide an adequate retirement income. Dentistry is a physically and emotionally demanding profession[2] and the Association, therefore, is opposed to tax measures

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(2) Journal of the Canadian Dental Association, Special Report, "Physical and emotional demands pose problems for dentists", 36: 57-59, February, 1970

which would discourage retirement at an appropriate age.

In the White Paper the Government states that "a number of goals and standards have guided the government in its approach to reform. They include a fair distribution of the tax burden based upon ability to pay; steady economic growth and continuing prosperity; the recognition of modern social needs; widespread understanding of and voluntary compliance with tax laws, combined with enough detail to block loopholes; and, finally, a system that can and will be used by the provinces as well as Canada."(3)

In this brief, the Association intends to express its views as to whether the proposals do indeed carry out the above aims of tax reform.

1. <u>ACCRUAL BASIS OF ACCOUNTING</u>

1.1 In the White Paper the Government proposes(4) that dentists be required to report their income on the accrual basis of accounting rather than the cash basis which is now permitted and that receivables and work in process at implementation date be brought into income in accordance with a specified formula(5). "The government believes that the tax postponement permitted by [the cash basis of accounting] has given professionals an

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(3) paragraph 1.6, p.6
(4) paragraph 5.46, p.68
(5) paragraph 5.47, p.68

unwarranted advantage by comparison to the rest of Canadians..."[6]

1.2 The Association strongly submits that there is no "unwarranted advantage" and that the proposal itself is unwarranted because:

(a) Employees (the majority of "the rest of Canadians") are only required to pay tax on money received during a taxation year and to suggest that a dentist (a "professional") should pay tax on money which he has not received is discriminatory and is not in conformity with the Government's expressed objective of equity among taxpayers. The officials of the Department of National Revenue recognize that receivables and work-in-progress are not equivalent to cash because they will not accept a transfer of these assets in payment of arrears of income tax.

(b) A businessman who pays tax on income computed in accordance with the accrual basis usually has inventories which he can pledge to his bank as security for a loan to pay his income tax. A dentist cannot pledge his work-in-progress as loan security.

(c) Newly licensed dentists will, if the proposal is accepted, not only be required to make substantial capital expenditures to establish a practice but would be required to pay a tax on moneys not received and on work not billed. It is

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(6) paragraph 5.46, p.68

easy to visualize a factual situation in which the dentist would be required to pay tax and have no money available for payment.

(d) Work in process would be difficult to evaluate for all dental services, and especially for those services being performed which will not be completed until after the close of a fiscal period, for example, bridge work and orthodontics.

(e) Accrual basis accounting would require dentists to maintain elaborate financial records thereby requiring time and energy which could be better devoted to providing health services.

(f) Substantial difficulties will be encountered in estimating a reasonable value for doubtful accounts and "bad debts", especially where the services have been provided on a compassionate basis. In addition, under some dental plans dentist's fees are pro rated and the dentist does not always know at what percentage his accounts receivable from these plans will be paid.

(g) In order to avoid the loss of time, the dentist would have to hire sophisticated accounting assistance which would serve to increase his operating expense and the cost of dental services to patients. This accounting assistance may be

impossible to obtain in rural areas where dentists are already overworked and their services in short supply.

(h) The dentist would be loath to provide services if he knew that the account would not be paid for some period of time. The view has been expressed by a number of dentists that if a dentist is required to pay tax on his accounts receivable, the natural tendency would be for him to reduce his accounts receivable to a minimum with the result that a dentist would carry on his practice on a cash basis. Any restriction of credit policy would deny dental services to persons until they had sufficient funds to pay for the services.

(i) Because the reduction of the rates of tax in the upper income brackets to the 50% level will not completely occur until 1976, the transition provisions requiring inclusion of the greater of accrual basis income or cash basis income may place the dentist in a higher tax bracket when the tax rates are greater than they will be in 1976.

1.3 The Association recommends that the cash basis accounting method now permitted to dentists be retained because:

(a) There is no "unwarranted advantage by comparison to the rest of Canadians".

(b) The disadvantageous effects not only on the dentists

but also on their patients from the use of the accrual basis greatly outweigh any advantages to be gained.

2. <u>EDUCATIONAL EXPENSES</u>

2.1 The Association supports the principle of continuing education, not only to produce the required dental teachers, research workers and specialists, but also to update the scientific knowledge and technological skills of the dental practitioner so that better dental services can be provided to the Canadian public. So important is continuing education considered that recently one province, Alberta, promulgated regulations requiring a dental specialist who wishes to renew his license after 5 years following the date of original issue and each 5 years thereafter to provide "evidence of completion of a minimum of 200 hours of lecture, clinical and laboratory training in each 5 year period of a nature acceptable to the Specialist and Specialization Committee appointed by the board".[7] Similar regulations are being considered for general practitioners in Alberta as well as in other provinces.

2.2 The "urgent requirement" for "some form of tax relief to encourage health professionals to maintain themselves abreast of new knowledge" was stressed by Dr. J. F. McCreary in his summary presented to the First National Health Manpower

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(7) By-law 13, Specialists and Specialization, Section 7(a), By-laws of the Alberta Dental Association, July 2, 1968

Conference sponsored jointly by the Department of National Health and Welfare and the Association of Universities and Colleges of Canada:

"[An urgent need which has been discussed at this Conference and] on many other occasions is the need for assistance in the provision of continuing education in the health services. With manifestly inadequate numbers in many of the health professions and with the very rapid growth of knowledge in these fields it is imperative that every member of the health professional group be as effective as possible...for a physician to attend a week long post-graduate course in a nearby city, the accumulated costs of his loss of income, maintenance of his office and staff, course registration fee and living expenses were $1,500. It is scant encouragement for him to refresh himself frequently under these circumstances. Although the same situation does not apply in exactly the same way to all members of the health professions, it assuredly does to dentists."(8)

2.3 Expenses of Graduate, Post-Graduate and Continuing Education Programmes

To date, it has been the policy of the Government and the tax courts to disallow expenses incurred in attending graduate, post-graduate and continuing education programmes on the ground that these expenses were of a capital nature and non-

(8) Dr. J. F. McCreary, Dean, Faculty of Medicine, University of British Columbia, Summary presented on the final day of the Conference, Ottawa, October 7-10, 1969

deductible. The only exception to this principle has been the provision for deduction of the student's tuition fees by the student notwithstanding the fact that these may have been paid by his parent. The Association recommends that consideration be given to the following:

(a) Tuition fees for graduate and post-graduate programmes given at recognized dental faculties, universities or teaching hospitals and continuing education courses recognized by provincial licensing bodies should be allowed as a deduction whether the course is taken at a Canadian or American institution as many such courses are still not available in Canada. The Association suggests that the option of the deduction of tuition fees be granted in the first instance to the student and if not taken by him then to the person actually making the payment. If the student does not take the deduction because his income does not exceed his basic exemptions and the deduction is not taken by the person making the payment, the student should be permitted to carry the tuition fee costs forward against future income in the same manner as businesses are entitled to carry forward business losses.

(b) Many graduate, post-graduate and continuing education programmes require the student to outlay moneys to purchase text

books and/or dental supplies which are used up during the programme. To date, no deduction has been granted in respect of the cost of these items. These items constitute the "tools of the trade" and the cost should be a permitted deduction. Again, if the dentist's income is insufficient to utilize the deduction, he should be permitted to carry the expense forward against future years' income in the same manner as businesses are entitled to carry forward business losses.

(c) In order to take the graduate, post-graduate or continuing education programme, the dentist frequently has to travel and pay for his lodging while at the same time maintaining a home. The dentist should be permitted to deduct his travelling and lodging expenses that are applicable to participation in these programmes. Again, as stated above, if the dentist's income is insufficient to utilize the deduction, he should be permitted to carry the expense forward against future years' income in the same manner as businesses are entitled to carry forward business losses.

2.4 Expenses of "Study Clubs"

Dentistry is one profession in which the practitioners are not in frequent personal communication such as in the legal profession where lawyers tend to meet at court houses and

registry offices or in the medical profession where doctors meet at hospitals. In order to promote free exchange of ideas among dentists, some groups of dentists have seen fit to form study clubs to promote post-graduate training and experience. The Association submits that the expenses incurred by a dentist in belonging to one of these study clubs should be a permitted deduction. The Association agrees that the wholesale deductibility of such expenses could lead to taxpayer abuse, but feels that controls could be implemented by requiring the expenses to be reasonable and the study group to have official recognition by a dental licensing body or university.

2.5 Convention Expenses

In the White Paper the Government proposes[9] that "...the Income Tax Act specifically deny deduction for entertainment expenses, the costs of attending or sending employees to conventions, and the costs of dues for membership in social or recreational clubs."

Each year the annual convention of the Association is devoted to three full days of scientific sessions designed "to foster the presentation and discussion of subjects pertaining to the improvement of the dental health of the public and the science and art of dentistry".[10] In addition, these conventions

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(9) paragraph 5.9, p.61
(10) Constitution and By-laws of the Canadian Dental Association, as adopted September, 1960 and including revisions to June, 1968, Article XXI, Section 1

promote the free exchange of ideas so necessary among dentists who, as previously stated, do not tend to meet in the same manner as doctors or lawyers.

Attendance at these meetings is costly because the dentist suffers a loss of earnings while having to maintain his office and pay travel, hotel and registration expenses.

At a time when the public is demanding increasingly high standards of health care and Government agencies are encouraging the health professionals to become more efficient and productive, it is paradoxical that the Government should seek to discourage one of the most efficient vehicles of professional continuing education.

The Association recommends that the present deduction of convention expenses be retained provided, of course, that such expenses are reasonable in the circumstances.

2.6 Fellowships, Scholarships, Bursaries and Research Grants

In the White Paper the Government proposes[11] as follows:

"Until now most fellowships, scholarships, bursaries and research grants not related to services have been treated as exempt from tax. There seems no valid reason for continuing such exemption. Post-graduate students and research workers

(11) paragraph 2.24, p.18

are, in effect, professional workers and should pay tax as others after allowances for tuition fees and for research expenses properly deductible from research grants. Payments to under-graduates normally fall well within personal exemptions, after deducting tuition fees. Where they exceed exemptions or where the student has other income he should pay a tax just as other Canadians do."

The Association submits that training more teachers and research workers should be encouraged in all possible ways, and therefore recommends the following:

(a) The proposal to tax fellowships, scholarships, bursaries and research grants should be reconsidered. In order to encourage dentists to give up time from their practice or to give up a practice entirely to undertake courses to qualify them as teaching or research dentists, or as specialists, it is necessary that inducements be given. It is well to argue that the effect of the tax change can be counteracted by increasing the amount of such grants, but in order to do so would require additional funds which may not be forthcoming. At present, some post-graduate students and research workers receive grants from federal agencies and it seems to the Association that the proposal would result in increased pressure on the Government

to raise its disbursements by way of grants. Grants received from non-governmental agencies would in all likelihood not be increased because any increase would have to be generated by increased voluntary contributions from dentists who, as previously pointed out, are a part of the middle class of taxpayers who will be required to pay additional tax under the proposals. Again, if the criterion is to be "ability to pay", it is inconceivable to think that persons receiving fellowships or bursaries have any great "ability to pay". It is suggested in the White Paper that tax reform "should interfere as little as possible with incentives to work" and the tax system be used in certain circumstances to provide incentives. It is the Association's submission that the incentive created by non-taxation of bursaries and fellowships should be retained.

(b) A dentist who obtains such a grant frequently has to travel and pay for his lodging while at the same time maintaining a home and possibly an office. The Association submits that if the Government feels that in the interests of equity such grants should be taxable, the extra expenses incurred by the dentist receiving the grant should be deductible. In many cases these extra expenses would exceed the amount of the grant. If the dentist's income is insufficient to utilize the extra

expense deduction, he should be permitted to carry the expense forward against future years income in the same manner as businesses are entitled to carry forward business losses.

2.7 Exchange Teachers

In the White Paper the Government proposes[12] the removal of the provisions under the present tax treaties entered into by Canada which exempt professors and teachers from foreign lands from Canadian income tax on their teaching salaries for two years.

The Association submits that this proposal will have the effect of eliminating incentives which have proven exceedingly valuable in attracting teachers of dentistry to this country and recommends that these incentives be retained.

3. MEDICAL EXPENSES

3.1 Since 1953, taxpayers have had the right to deduct from income the amount of medical and dental expenses exceeding 3% of their income. Since that time national hospital and medical insurance plans have been introduced and neither amounts recoverable from these public plans nor premiums paid to such plans are deductible.

In the White Paper the Government proposes[13] that medical expenses recoverable from private plans will also be

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(12) paragraph 2.26, p.18
(13) paragraph 2.20, p.17

excluded from allowable medical expenses although the premiums paid to private plans would be classed as allowable medical expenses. Many individuals through taxes or premiums earmarked for public plans pay the equivalent of at least 3% of their income to public plans but still 3% of their income must be deducted from other health service expenditures before any amount will be deductible.

The Association recommends that the 3% qualification limit should be reduced in order to facilitate deduction of dental and other health expenses by taxpayers in all income brackets.

4. PERSONAL EXEMPTIONS

4.1 In the White Paper the Government proposes[14] that personal exemptions be increased to $1,400 from $1,000 for single taxpayers (or married taxpayers filing as single) and to $2,800 from $2,000 for married taxpayers filing as such. It is indicated that the increased exemptions combined with the $100 standard deduction for charitable and medical expenses and the proposed employee expense allowance of $150 would free from income tax about 750,000 Canadians now subject to tax and would reduce taxes on another 3,000,000 persons at the low end of the taxable scale.

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(14) paragraph 2.4, p.14

However, in order to recoup the revenue loss because of the increased exemptions, the Government proposes amending the tax rate schedules in such a manner that single persons having an income in excess of $3,400 per year and married persons having an income in excess of $9,100 per year would pay a greater amount of tax than now payable under current law.

4.2 Increased exemptions have the effect of granting to high income taxpayers a greater tax exemption than to low income taxpayers. For example, at the 50% tax level a $400 increase in exemption means a $200 reduction of tax, whereas at the 21% level the saving is only $84. Where a taxpayer now has income of less than $1,100 the additional exemption is of no particular benefit to him.

4.3 The Association recommends that a flat amount creditable against tax payable be established rather than increasing exemptions (which because of varying tax rates give varying tax credits) which would accomplish the Government's objectives of relieving or reducing income tax payable by 3,750,000 taxpayers while at the same time not causing an exorbitant reduction in revenue which must be recouped by increasing the taxes of the middle income group.

5. INCOME AVERAGING

In the White Paper the Government has proposed a complicated formula to permit a taxpayer with substantial income in one year to average his excess income over prior taxation years, while retaining the present averaging formula for farmers or fishermen.[15] In addition, the Government proposes that certain payments out of pension funds could be averaged on the formula or paid into registered retirement savings plans. A similar opportunity to pay extra amounts into registered retirement savings plans may be given "to those having certain other types of irregular or short-term incomes such as authors and professional athletes".[16]

The Association submits that:

(a) In the interests of equity all taxpayers should be permitted to average their incomes on the same basis when fluctuations in income result from extraordinary events such as taking lengthy post-graduate courses, capital gains, etc.

(b) The projected income tax saving to be gained by the use of the averaging provisions is illusory and not of considerable advantage. By reference to Table 12 of the White Paper[17] it can be readily seen that the tax saving is minimal.

(c) The dental student incurs many years of low or no income in order to attain his professional status, yet he is

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(15) paragraphs 2.56 and 2.57, p.23
(16) paragraph 2.57, p.23
(17) p.35

not permitted to carry forward his educational expenses against future income. The Government specifically proposes[18] that a person under 25 years of age could use only an unbroken series of years since the last year in which he had no tax to pay and to assume an arbitrary income of $5,000 per year for the years excluded. The newly licensed dentist may have a substantial income in his first year of practice, particularly under the accrual basis of reporting income, yet gains no benefit from the averaging provisions. The newly licensed dentist embarking on his practice would earn income in excess of $3,400 and if filing as an unmarried taxpayer would be required to pay increased tax notwithstanding that he does not have the "ability to pay" because of heavy debts which he may have incurred while attending university. He is not granted any credit for the inordinate expenses of learning his profession. The Association is of the opinion that this does not create equity in taxation.

(d) The Government has seen fit to allow an averaging where a person's income is in excess of his "threshold amount" for prior years, but has not seen fit to allow an averaging where there is a decrease in income due to taking lengthy post-graduate courses, illness and capital losses. In the Association's view, this is inequitable and not in conformity with the

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(18) paragraph 2.59, p.23

equity among taxpayers view.

The Association recommends that:

(a) All taxpayers should be permitted to average their incomes on the same basis when fluctuations occur because of extraordinary events or, in the alternative, taxpayers should be permitted to make payments into registered retirement savings plans in the same manner as authors and professional athletes in accordance with the proposals of the Royal Commission on Taxation.

(b) In order to provide some allowance for the substantial expenses incurred by the student in studying dentistry and in setting up his practice, the Association suggests that the dentist be permitted to carry forward his educational expenses against future years' income in the same manner as businessmen are entitled to carry forward business losses and the same taxation incentives be granted to the dentist that are granted to any other small businessman.

6. UNITED STATES-CANADA TAX

As previously stated, increased exemptions granted to taxpayers will result in increased taxes being imposed on middle income taxpayers in order to counteract a loss of Government revenue. The Association is concerned that at least one of the provinces disputes the amount of taxes which will be raised under

the new rate schedule. Since the majority of dentists will be in the middle income group, it is the Association's submission that the conflicts in estimates be fully explored and resolved.

The Association also submits that in view of the recent tax changes in the United States of America a full review be made of the tax burdens proposed on middle income taxpayers in both countries.[19] The Government appointed Task Force on the Cost of Health Services recently stressed the problem of Canada being in competition for health professionals with the United States where earnings are higher. American dental authorities acknowledge the need for more dentists in the United States and the Association does not wish to see a loss of qualified dentists to the United States for tax reasons.

7. FAMILY UNIT

In the White Paper the Government indicates[20] that it considered and rejected the "family unit concept" as proposed by the Royal Commission on Taxation. The Association, as indicated in previous submissions to the Government, did not agree with the family unit concept because it would deter wives from working as dentists, hygienists and dental assistants. The Association, therefore, is in agreement with the Government's position.

The Government also indicated that it intends to

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(19) See, for example, David B. Perry, "Canadian and U.S. Income Taxes: A Comparison", Canadian Tax Journal, 18:54-57, January-February, 1970
(20) paragraph 2.5, p.14

reconsider the family unit basis after the basic reforms proposed in the White Paper are in effect. The Association urges the Government in undertaking any such reconsideration to consider the implementation of a joint return filing by husband and wife such as is in effect in the United States of America. Such a joint return filing would have the advantage of reducing taxes and encouraging wives to work.

8. CHILD EXPENSES

In the White Paper the Government proposes[(21)] that working parents, under controlled conditions, should be entitled to deduct as child care expenses amounts up to $500 per child under the age of 14, or $2,000 per family.

The Association recommends that no arbitrary limits be imposed, but that the amount of such deductions be generally limited by a consideration of the reasonableness of the expenses when compared with the amount of income earned by the wife.

9. EXPENSES

9.1 Wages Paid to Wives

For quite some time members of the profession have been concerned about the discrepancy under Section 21(2) of the Income Tax Act which denies the proprietor or partner in an unincorporated business to deduct remuneration paid to his spouse,

(21) paragraphs 2.7, 2.8 and 2.9, p.15

whereas if the business is incorporated the deduction is permitted.[22] The White Paper proposals respecting corporations and their shareholders have been formulated with the express intention that there should be no tax advantages arising from the fact of incorporation. In this regard, the dentist who, for the sake of economy or because of the business ability of his wife, sees fit to employ her in his office would be penalized because under provincial legislation he is not permitted to incorporate his practice.

The Association recommends that Section 21(2) of the Income Tax Act be repealed and that a dentist be entitled to deduct any remuneration paid to his wife subject to the amount of such remuneration being reasonable in the circumstances.

9.2 Entertainment Expenses

In the White Paper the Government proposes[23] that the Income Tax Act "specifically deny deduction for entertainment expenses" notwithstanding that the expenses are "laid out for the purpose of gaining or producing income from the business". A dentist is not permitted to advertise and his patients are derived through referrals from his patients, other practitioners and his friends and acquaintances.

The Association recommends that entertainment expenses,

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(22) See, for example, Gwyneth McGregor, "Wives of the World Unite!", Financial Post, December 27, 1969, which was reprinted in the February issue of the Journal of the Canadian Dental Association

(23) paragraph 5.9, p.61

as such, should be allowed as a deduction provided they are reasonable in the circumstances.

9.3 Employment Expenses

In the White Paper the Government proposes[(24)] a general deduction for employment expenses of 3% of gross employment income up to a maximum of $150 per year.

The Association submits that the maximum deduction is not realistic when considered in the light of expenses incurred by employee dentists in "earning their income". A dentist by his profession is expected to continually engage in a self-education programme which requires his attendance at scientific meetings, the purchasing of various periodicals and membership in dental organizations participation of which is not necessary to maintain a professional status recognized by statute. The Association submits that the taxpayer should have an option to maintain detailed records to support a claim for a deduction in excess of $150.

9.4 Employee Moving Expenses

In the White Paper the Government proposes[(25)] that a taxpayer be permitted to deduct moving expenses when he moves from one job to another. As discussed later in this brief,[(26)] a dentist moving his practice from one area to another may not

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(24) paragraph 2.13, p.16
(25) paragraph 2.15, p.16
(26) p.28, 29 and 30

have a "change of job". The Association recommends that moving expenses of dentists be deductible.

9.5 Depreciation

In the White Paper the Government proposes[27] to close a loop-hole which permits taxpayers to purchase depreciable property and deduct from their other income any loss realized from the holding of the property notwithstanding that the loss was created by the deduction of capital cost allowance, interest or property taxes. The loop-hole is to be closed by prohibiting the deduction from other income of a loss which results from the deduction of the above items.

If this proposal is implemented, the Association submits that in directing its attention towards the closing of a loop-hole the Government has also unduly penalized dentists who bona fide and for the sake of investment purchase a property in which to carry on their dental practice.

The Association recommends that the Government's proposal, if implemented, exempt from its operation the deduction of any loss which occurs from the ownership of rental property in which the landlord carries on business.

10. RETIREMENT - PENSION PLANS AND RETIREMENT SAVINGS PLANS

10.1 In the White Paper the Government proposes[28] to

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(27) paragraph 5.17, p.63
(28) paragraph 2.50, p.22

retain the existing limits on contributions to pension plans of a maximum of $3,000 between employer and employee in respect of payments into employee pension plans and $2,500 in respect of a registered retirement savings plan established on behalf of the self-employed person. These contribution limits were established for employee pension plans in 1954 and for registered retirement savings plans in 1957. Since those dates the purchasing power of the dollar has been eroded through inflation and consideration should be given to increasing these limits to provide adequate pensions at retirement dates.

In the light of the expressed intention of the Government that there be equity among taxpayers, it is the Association's recommendation that the maximum contribution which could be made by a self-employed person should be the same as the $3,000 payment which may be made on behalf of an employee.

10.2 In the White Paper the Government proposes[29] that at least 90% of the assets of pension plans and registered retirement savings plans be invested in Canada. At the same time, it would deny to these plans the refund of corporation tax paid by the company from which dividends are received because "rate of growth of pension and retirement savings funds, [is] due in part to their tax-free status".

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(29) paragraph 4.60, p.56

The Association submits that the effect of the corporation tax credit will be that security purchase prices will increase because the investing public will look to yield plus tax credit in determining prices to be paid. The plans will be required to pay higher prices for securities but may not receive the same yield as other Canadian taxpayers with the effect that the Government's tax-free status argument will no longer be valid. The Association also submits that the effect of the proposal will be that a plan will invest the maximum amount of 10% of its assets in foreign securities in order to obtain increased yields, whereas if the corporation tax credit was given there would be a tendency for the plans to invest all of their assets in Canada.

10.3 In the White Paper the Government proposes[30] that death benefits paid to widows out of pension plans or registered retirement savings plans be taxed at ordinary rates rather than the flat 15% rate now in effect subject to a deduction of all amounts paid by the widow into a registered retirement savings plan. The Association submits that the substantially increased estate taxes implemented as a result of the October 22, 1968 Budget plus the additional income tax paid would cause a substantial reduction in moneys available to surviving widows.

(30) paragraph 2.50, p.22

pension plan funds may need to be utilized to pay estate and succession taxes and the funds will not be contributed to a registered retirement savings plan.

11. CAPITAL GAINS

The Association, being a membership of taxpayer-dentists, is concerned, in the same manner as other taxpayers, in regard to the Government's proposals for the taxation of capital gains. It is understood, however, that numerous submissions will be made on these provisions by other taxpayers, and in this brief the Association intends to comment only on certain proposals of specific interest to the dental profession.

11.1 Principal Residences

In the White Paper the Government proposes[31] that there be a tax on any gain on the sale of a principal residence in excess of specified exemptions per year of occupancy subject to a "rollover" if a taxpayer moves from one area to another within Canada "in connection with a change of job".

The Association submits that:

(a) The revenue realized by a tax on the sale of principal residences would be insignificant in comparison with other revenues.

(b) Clarification should be given to the meaning of

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(31) paragraph 3.19, p.38

"a change of job". A dentist is a dentist and if he moves to another area he will still be carrying on the practice of dentistry. Is this a change of job? It is the Association's submission that in relationship to a dentist the rollover would not be available because there would not be a change of job.

(c) The Association is interested in dentists continuing their education and to this aim encourages them to attend courses given in other areas of Canada or in the United States. If such a dentist were to sell his home for the purpose of moving to another area to study, the rollover may not be available if the transition from practising dentist to student is not a change of job.

The Association recommends that:

(a) A capital gain derived from the sale of a principal residence should not be taxed.

(b) In the alternative, there should be a rollover if a new residence is purchased within a reasonable time of the sale.

(c) Dentists who move on a temporary basis to an area outside Canada should be entitled to elect to continue as Canadian residents and the rollover exemption should be available provided that the funds received from the sale of the property are expended within a reasonable time on the dentist's

return to Canada.

(d) In the alternative, a dentist who moves to a new area to establish a practice or to study should be permitted the rollover exemption.

(e) In the alternative, the exemption per year of occupancy should be related to the value of the house when purchased.

11.2 Deemed Realizations

In the White Paper the Government proposes[32] that when a taxpayer gives up Canadian residence he be treated as if he sold all his assets on that day at their fair market value and be required to pay tax on his deemed capital gains.

As previously stated, the Association encourages dentists to obtain education in foreign lands and if the proposal of the Government is adopted a dentist who leaves Canada for a temporary purpose would be required to pay a tax on his deemed capital gains.

The Association suggests that the recommendation of the Royal Commission on Taxation be adopted and that a taxpayer who leaves Canada be given an election to continue as a Canadian resident and thereby avoid the tax on the deemed capital gains.

11.3 Goodwill of a Dentist's Practice

A dentist will be unable to deduct the value of goodwill

(32) paragraph 3.40, p.42

as of valuation day from the total price received from the future sale of his practice. He will be required to pay tax in the first year on 40% of the proceeds in respect of goodwill with an increase to 45% in the second year and so on with an annual increase of 5% each year until in the 13th year 100% of any proceeds received in respect of goodwill would be taxable.

For example, if on valuation date a dentist's practice has a value of $50,000 of which $20,000 is referable to goodwill and he sells his practice for $50,000 one year after implementation date, he will be required to include in his income 40% of the $20,000 received for goodwill and pay tax thereon.

The Association submits that the Government's proposal to tax the goodwill on an asset sale constitutes retroactive taxation.

The Association suggests that the value of goodwill of a dental practice on valuation day should be excluded from tax and only the difference between the amount of proceeds received for goodwill on the sale and the value on valuation day should be subject to the capital gains' tax.

12. CORPORATIONS AND THEIR SHAREHOLDERS

It is understood that numerous submissions will be made by taxpayers on the proposals in this area and it is

intended that the Association in this brief will comment only generally on the proposals.

The difference in taxation of income from investments in closely held companies as opposed to widely held companies and the difference in taxation of capital gains arising from the sale of shares in such companies is not warranted and unduly penalizes the holders of shares of closely held corporations. Such shareholders would, it is submitted, be to a great extent middle income taxpayers.

13. GIFTS AND BEQUESTS

In the White Paper the Government proposes(33) that an income tax on the gains accrued on assets owned by a deceased at the date of his death will not be taxable unless or until the executor or beneficiary disposes of the asset. In those situations where there is insufficient liquidity in an estate to pay the estate taxes and it is necessary that the asset be sold, the resultant aggregate estate tax and income tax payable can be equal to 75% of the value of the asset. For example, if a person dies owning an asset having an inherent capital gain of $100,000 and his estate is in a 50% estate tax bracket, there will be an estate tax of $50,000 payable in respect of the accrued capital gain. If the executor or beneficiary is required to sell the

(33) paragraph 3.42, p.42

asset and is in a 50% income tax bracket income tax payable on the capital gain of $50,000 (the $100,000 gain minus the estate tax payable on the gain) would be $25,000, leaving the executor or beneficiary with only $25,000 of the original $100,000 accrued capital gain.

The Association submits that the effect of this proposal will be that an excessive tax will be collected on capital gains.

The Association recommends that either the estate tax or the income tax on the capital gains should be applied and not both taxes.

14. INVESTMENT INCOME OF CLUBS AND OTHER NON-PROFIT ORGANIZATIONS

In the White Paper the Government proposes[34] that investment income of associations such as the Canadian Dental Association be subjected to corporation tax.

The Association submits that the amount of revenue to be derived by the Government by this proposal is minimal when compared to its other sources of revenue and the proposal will only have the effect of taking away from the Association a source of income. If this income source is lost the Association would be required to recoup its lost income from increased dues or curtail its activities which are of great importance to both

(34) paragraph 5.54, p.69

the dental profession and the public.

The Association suggests that it would not be opportune to increase dues payable by dentists at a time when dentists as members of the middle income class are being subjected to increased taxes. In addition, any increased dues would be deductible by dentists with a resultant loss of revenue to the Government. The net effect on Government revenue would be minimal if the proposal is implemented.

CONCLUSION

The Association greatly appreciates the opportunity it has been given to present its views on the White Paper and has endeavoured in this brief to suggest reasonable alternatives to those proposals which it believes would have detrimental effects on the profession and the public it serves.

APPENDIX "I"

NAME: CANADIAN DENTAL ASSOCIATION

SUBJECT: Commentary on White Paper Proposals

Analysis of Appendix "H" by Senior Advisor

This Brief is submitted by the Canadian Dental Association which is the national organization of ten provincial dental organizations representing some 7,000 individual dentists.

The Canadian Dental Association has prepared a comprehensive summary and listed the subject matter, the recommendations made, and a reference to the page and paragraph of the actual brief.

The Brief deals with twenty-two different points. It goes into considerable details in those points which are of particular concern to dentists and refers to points that the Association believes will be more fully dealt with in other submissions.

The usual summary of present tax laws, White Paper proposals and principal points of the brief is attached.

Name : CANADIAN DENTAL ASSOCIATION

Date Brief Received:

Principal Subject: Accrual Basis of Accounting

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 85F-1 of the Income Tax Act	The proposals of the White Paper respecting accrual basis of accounting for persons carrying on a profession are contained in the following paragraphs:	Pages 4, 5 and 6, paragraph 1.2 of the Brief
This section permits a taxpayer carrying on a profession to determine his income on a cash basis, as opposed to other taxpayers carrying on business who are required to use the accrual basis. Unbilled work does not have to be included in computing income.	5.46 Generally, taxpayers who are in business must compute their taxable income on what is known as the accrual basis. This means that a merchant must take into account the inventory of goods he has on hand, the amounts due to him from his customers, and the amounts he owes to his suppliers. An exception to this general rule has for many years been made for taxpayers in the professions (doctors, dentists, lawyers, chartered accountants, professional engineers, etc.). These taxpayers have been permitted to choose to report their income either on the accrual basis or on the cash basis—that is, they could omit the amounts due them from their clients and their "inventory" of unbilled time. Once a taxpayer chooses one basis he cannot switch to the other without the consent of the Minister. The government believes that the tax postponement permitted by this concession has given professionals an unwarranted advantage by comparison to the rest of Canadians, and it therefore proposes that professionals be required to use the accrual basis.	The Association strongly submits that there is no "unwarranted advantage" and that the proposal itself is unwarranted. Newly licensed dentists would be required not only to make substantial capital expenditures but also to pay tax on monies not received and work not billed. Work in process is difficult to evaluate. The accrual method would require the maintenance of elaborate financial records and thus reduce the time available to provide health services. The Brief recommends that the cash basis of accounting be retained because (a) there is no "unwarranted advantage by comparison to the rest of Canadians", and (b) of the disadvantageous effects not only on the dentists but also on their patients.

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	5.47 A problem would exist in switching professional taxpayers now on the cash basis over to the new system. This problem relates to their receivables and inventories at the date of the change over. For example, if 1971 is the first year of the new system, the problem would relate to the receivables and inventories as at the end of 1970. These amounts would not have been included in the taxpayer's 1970 income because they would not have been collected at that time. They would not be included in the 1971 income because they were earned before that time. To require that the entire amount be brought into 1971 income would impose an abnormal tax liability in that year. As a consequence, the government proposes that these taxpayers be entitled to bring these amounts into income over a number of years. Specifically, they would bring them into income as their total outstanding receivables and inventories are reduced. This amount would of course be in addition to the amount of their income computed on the accrual basis and would mean that they would be taxed on the greater of a cash-basis income or an accrual-basis income until they catch up to other Canadian businessmen.	

Name : CANADIAN DENTAL ASSOCIATION

Date Brief Received:

Principal Subject: Educational Expenses
(A) Tuition fees

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Sections 11-1-qb and qc of the Income Tax Act These sections permit taxpayers to deduct tuition fees paid in determining income, provided he has not been reimbursed for the fees so paid.	1.37 It is also proposed, in fairness to other taxpayers, that fellowships, research grants, scholarships and bursaries be treated as taxable income but subject to the deduction for tuition fees and costs incurred for research. Undergraduates would seldom need to pay tax because few scholarships and bursaries are larger than the new personal exemptions plus the fees that may be deducted from students' incomes. But if students have other income, there is no reason why they should not be taxed like other Canadians. 2.24 Until now most fellowships, scholarships, bursaries and research grants not related to services have been treated as exempt from tax. There seems no valid reason for continuing such exemption. Post-graduate students and research workers are, in effect, professional workers and should pay tax as others, after allowances for tuition fees and for research expenses properly deductible from research grants. Payments to undergraduates normally fall well within the personal exemptions, after deducting tuition fees. Where they exceed exemptions or where the student has other income, he should pay tax just as other Canadians do.	Page 7, paragraph 2.1 of the Brief The brief supports the principle of continuing education and points out that Alberta requires dental specialists to provide evidence every five years of their technical skill. Page 8, paragraph 2.3 of the Brief The brief sets out the present policy by which costs of graduate, post-graduate and continuing education programmes are considered to be of a capital nature and non-deductible.

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		Page 9 of the Brief The brief recommends that (1) tuition fees for graduate and post-graduate programmes given by recognized dental facilities, universities and hospitals and continuing education courses recognized by provincial licensing bodies be allowed as a deduction; (2) the deduction of the tuition fee be granted to the student and if not taken by him - to the person making the payment; (3) if the deduction is not taken by the person making the payment, that the student be permitted to carry tuition fee costs forward against future income.

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		Pages 9 and 10 of the Brief The brief states that the same treatment should be afforded to the costs incurred (a) to purchase text books and dental supplies required for the educational programme, and (b) to travel to and reside at the locations where the educational programme is conducted should be treated in the same way as tuition fees.

Name : CANADIAN DENTAL ASSOCIATION

Date Brief Received:

Principal Subject: Educational Expenses
(B) Study Clubs

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The Income Tax Act makes no reference to this type of expense.	The White Paper contains no proposals upon this type of expense.	Pages 10 and 11 of the Brief The brief points out that dentistry as distinct from most other professions, is normally conducted by a sole practitioner. The submission is made that expenses incurred in belonging to such clubs, within limits, should be allowable as expenses.

Name : CANADIAN DENTAL ASSOCIATION

Date Brief Received:

Principal Subject: Educational Expenses
(C) Convention Expenses

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 11-1-ia of the Income Tax Act This section permits the deduction of expenses incurred in attending not more than two conventions in a year.	2.11 The government has considered this issue at length. It proposes two sets of measures to remedy the disparity. First, in regard to those in business and the professions, and to certain types of benefits granted by employers to senior employees, it intends to set more rigorous limits to check "expense account living." The costs of attending conventions and belonging to clubs would no longer be permitted as a charge in determining business income. The costs of yachts, hunting and fishing lodges or camps, amounts spent for tickets for games and performances, and costs of entertainment would also be excluded. Owners or employees of a business having a car or aircraft available to them for their personal use, including travel to and from home, would have to pay the business a minimum stand-by charge, or have a corresponding amount added to their personal income for tax purposes.	Pages 11 and 12 of the Brief The brief points out that their association devotes three full days to scientific sessions that afford a means of promoting the free exchange of ideas. The brief recommends that the present deduction of convention expenses be retained.

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	5.9 Although the government believes that provision should be made for the deduction of legitimate business expenses that have not previously been deductible, it also believes that the present system permits deduction of certain types of expenses which taxpayers should be expected to meet out of tax-paid income. Consequently it is proposed that the Income Tax Act specifically deny deduction for entertainment expenses, the costs of attending or sending employees to conventions, and the cost of dues for membership in social or recreational clubs. This provision would not prohibit the expenditure of funds for these purposes, but it would ensure that taxpayers who wish to make such expenditures would do so out of after-tax dollars.	

Name : CANADIAN DENTAL ASSOCIATION

Date Brief Received:

Principal Subject: Educational Expenses
(D) Fellowships, Scholarships, Bursaries and Research Grants

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The Income Tax Act provides for the taxation of grants received if they are in fact paid to an employee of the employer paying the grant, even though that employer may receive a subsidy in respect thereof. The Income Tax Act does not levy tax on grants received when the recipient is not an employee of the person making the grant and the grant is made voluntarily	1.37 It is also proposed, in fairness to other taxpayers, that fellowships, research grants, scholarships and bursaries be treated as taxable income but subject to the deduction for tuition fees and costs incurred for research. Undergraduates would seldom need to pay tax because few scholarships and bursaries are larger than the new personal exemptions plus the fees that may be deducted from students' incomes. But if students have other income, there is no reason why they should not be taxed like other Canadians. 2.24 Until now most fellowships, scholarships, bursaries and research grants not related to services have been treated as exempt from tax. There seems no valid reason for continuing such exemption. Post-graduate students and research workers are, in effect, professional workers and should pay tax as others, after allowances for tuition fees and for research expenses properly deductible from research grants. Payments to undergraduates normally fall well within the personal exemptions, after deducting tuition fees. Where they exceed exemptions or where the student has other income, he should pay tax just as other Canadians do.	Pages 12, 13, 14 and 15 of the Brief The brief submits that the training of more teachers and research workers should be encouraged. The brief submits: (1) The proposal to tax such grants should be reconsidered. (2) It is inconceivable to think that persons receiving grants have any great "ability to pay". (3) That tax reform should interfere as little as possible with incentives to work. (4) That the incentives created by exemption from tax of bursaries and fellowships should be retained.

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		The brief recommends that if the government feels in equity such grants should be taxable, then (a) all expenses incurred by the recipient of the grant should be deductible, and (b) any excess of expenses over the grant should be allowable as a deduction against future income.

Name : CANADIAN DENTAL ASSOCIATION

Date Brief Received:

Principal Subject: Educational Expenses
(E) Exchange Teachers

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Canada has entered into Income Tax Agreements with a number of countries. All of these agreements, except that with France, provide for the exemption of a professor or teacher from Canadian income tax for one period of up to two years on his remuneration from teaching if he has come to Canada temporarily for the purpose of teaching and if his stay in Canada is not expected to exceed twenty-four consecutive months.	2.26 Under our tax treaties with Britain, the United States and a number of other countries, professors and teachers who have come to Canada temporarily are exempt from Canadian income tax on their teaching salaries for two years. In some circumstances they are not taxed by the country where they are normally resident. Given the present scale of salaries of professors and teachers this arrangement is unjustified. We intend to remove this exemption, on a reciprocal basis, from our treaties and to tax such persons like others.	Page 15 of the Brief The brief submits that this proposal will eliminate the incentives that have helped to attract teachers to Canada. The brief recommends that these incentives be retained.

Name : CANADIAN DENTAL ASSOCIATION

Date Brief Received:

Principal Subject: Medical Expenses

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Sections 27-1-c; 27-1-ca, 27-4 and 27-4a of the Income Tax Act These sections permit a taxpayer to deduct certain specified medical expenses to determine taxable income to the extent these expenses exceed 3% of the income and that they are not reimbursed to him under a medicare plan of a province or Canada.	1.25 To remove or reduce taxes on lower-income taxpayers the government proposes to increase the basic personal exemption for a single person to $1,400 from $1,000 and for a married couple to $2,800 from $2,000. The basic standard deduction available in lieu of deductions for charitable donations and medical expenses would remain at $100. Consequently those taxable as single persons with income under $1,500 would have no tax to pay and those taxable as married would have no tax to pay if their incomes were under $2,900. These new exemptions would be much higher than those in other countries as shown in Table 3 page 26. 2.18 An additional amount of $500 is currently added to the personal exemption for a person over 70, or for a blind person, or for a person confined to a wheelchair. Although the royal commission recommended that this be cancelled, it is proposed to continue this additional exemption for such taxpayers on compassionate grounds. It can be argued that this is not the best way to assist the incapacitated or the elderly but most of the incapacitated benefiting from this provision have relatively small incomes, and taxpayers' needs tend to increase with age.	Pages 15 and 16 of the Brief The brief submits that many individuals, through taxes or premiums earmarked for public plans pay the equivalent of at least 3% of their income to public plans, but still 3% of their income must be deducted from other health service expenditure before any amount will be deductible. The brief recommends that the 3% qualification limit be reduced to facilitate the deduction of dental and other health expenses by taxpayers in all income brackets.

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	2.20 Now that medical care as well as hospital care are covered by comprehensive public plans supported to a large extent by federal expenditures, it is proposed to change somewhat the basis on which medical expenses may be claimed. No expenses paid or recoverable from such public plans now are included in medical expenses for purposes of the Income Tax Act, nor any premiums paid by taxpayers toward such plans. The first provision is necessary to reflect the fact that such plans are already supported out of federal revenue; the second is essential for fairness because some provinces finance their plans largely from general revenue, which cannot be identified or allowed as a deduction, and others by premiums of various sizes. It is now proposed, as the royal commission recommended, that all medical expenditures for which a taxpayer has been reimbursed, or is entitled to be reimbursed, from an insurance or prepayment plan should not be classed as medical expenses for tax purposes. Instead premiums or contributions paid to plans other than government plans would be classed as medical expenses for this purpose. Medical expenses not recoverable from either public or private plans would continue to be deductible where they exceed 3 per cent of the taxpayer's income. One other change in the law will also be proposed to place contributions to public medical care plans on the same basis as contributions to public hospital care plans. This would provide that an employer's contributions on behalf of an employee be treated as a taxable benefit received bv the employee.	

Name : CANADIAN DENTAL ASSOCIATION

Date Brief Received:

Principal Subject: Personal Exemptions

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 26 of the Income Tax Act This section generally allows a $2,000 exemption of persons who can qualify for married status and $1,000 for those persons who cannot qualify for married status. Additional allowance of $300 or $550 are allowed for dependents and an additional allowance of $500 is given to persons who have attained the age of 70.	1.25 To remove or reduce taxes on lower-income taxpayers the government proposes to increase the basic personal exemption for a single person to $1,400 from $1,000 and for a married couple to $2,800 from $2,000. The basic standard deduction available in lieu of deductions for charitable donations and medical expenses would remain at $100. Consequently those taxable as single persons with income under $1,500 would have no tax to pay and those taxable as married would have no tax to pay if their incomes were under $2,900. These new exemptions would be much higher than those in other countries as shown in Table 3 page 26. 2.4 These factors led the government to propose an increase in personal exemptions to $1,400 from $1,000 for single taxpayers (or married taxpayers filing as single) and to $2,800 from $2,000 for married taxpayers filing as such. The deductions for children and other dependants would remain the same, although some of the conditions relating to them would be changed as noted below. These new exemptions plus the $100 standard deduction, which would be continued, would mean that those entitled to the married exemption would be exempt up to an income of $2,900 and single persons to $1,500. These increases would free from income tax about 750,000 persons now subject to tax.	Pages 16, 17, 18, 19 and 20 of the Brief The brief points out that the increased exemptions grants a greater tax exemption to high income taxpayers than to low income taxpayers. The brief recommends that a dollar amount creditable against tax be given instead of increasing exemptions and thus not cause an exhorbitant reduction in revenue which must be recouped by increasing the taxes of the middle income group.

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	2.16 The law now permits a taxpayer to claim the exemption of a married person under certain circumstances even though not married or married but separated. It is proposed to continue this special use of the exemption only for those who support a child or other relative who lives with the taxpayer. Where they live elsewhere, only the deduction for supporting the dependant would be allowed, plus the new child care deduction, if it applies. The provision that permits both a married exemption and a deduction for dependants to be claimed where a fulltime servant is employed would be dropped as unnecessary in view of the new child care deduction. The married exemption would also be discontinued for an unmarried clergyman who employs a fulltime servant and maintains a self-contained domestic establishment.	

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Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	2.17 It is necessary to reduce the extra exemption for married status where the wife or husband of the taxpayer has an income and to reduce the deduction for children or other dependants where they have an income of their own. This should be done gradually by reference to the income of the dependant so there is no abrupt dividing line causing unfairness between those just over and just under it. For this purpose it is proposed that the additional exemption of $1,400 for a married man be reduced by $1 for every $1 that his wife's income exceeds $100, so that he would be taxed as a single person when her income is just enough to make her taxable. The same rule would apply where a wife supports her husband. In the case of children under 16, for whom the deduction is $300 (and for whom family allowances are normally payable) it is proposed that the parent's deduction be reduced by $1 for every $2 of income of the child in excess of $900, so that the deduction would disappear when the child is taxable on his own income. For older children and other dependants, for whom the deduction is $550, the taxpayer's deduction would be reduced by $1 for every $1 that the dependant's income exceeds $950, so that this deduction too would disappear when the "dependant" becomes taxable. The amount of $950 is used in the present rule for dependants but the deduction is abruptly cut off when income exceeds this level. In determining the income of a student, for this purpose as well as for his own taxable income, tuition fees may be deducted.	

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	2.18 An additional amount of $500 is currently added to the personal exemption for a person over 70, or for a blind person, or for a person confined to a wheelchair. Although the royal commission recommended that this be cancelled, it is proposed to continue this additional exemption for such taxpayers on compassionate grounds. It can be argued that this is not the best way to assist the incapacitated or the elderly but most of the incapacitated benefiting from this provision have relatively small incomes, and taxpayers' needs tend to increase with age.	

Name : CANADIAN DENTAL ASSOCIATION

Date Brief Received:

Principal Subject: Income Averaging

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The Income Tax Act does not permit persons practicing a profession to average income.	2.53 Income tax is levied on a year's income at a time, at a rate that normally depends on the size of that year's income alone. But some types of income are irregular, and tax must be paid at a higher rate in a year when income is abnormally high. This may cause taxpayers with irregular or varying incomes to pay significantly higher taxes over a series of years than those whose incomes are more regular. Special provisions in the existing law permit farmers and fishermen to average their incomes over a block of five years, authors over three years, and businessmen on certain unusual types of income over three or five years. Certain types of single payments out of pension funds, or by employers on retirement of an employee, can be taxed at the average rate of tax paid by the employee over the preceding three years. 2.54 The introduction of a capital gains tax, particularly one in which accrued gains on shares in widely-held Canadian corporations are taxed periodically, would increase the need for a more general averaging formula, because many more taxpayers will occasionally have incomes much higher than their average incomes. The royal commission noted this need under a capital gains tax and recommended for all taxpayers an averaging formula similar to that now available to farmers. It also recommended that "deposit averaging" be permitted, under which a taxpayer could deposit with the government a portion of his income—on an interest-free basis—and pay no tax on it until it was withdrawn.	Pages 18, 19 and 20 of the Brief The brief submits that (1) all taxpayers should be permitted to average their income; (2) the proposal should be available to a newly-licenced dentist who might have substantial income particularly if the accrual system is implemented (3) while averaging is allowed if income exceeds "threshold amount", averaging is not allowed when there is a decrease in income.

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	2.55 The government has reached the view that a general averaging formula should be available to all individual taxpayers. However, it proposes a much simpler and more automatic system than the royal commission did. Averaging would introduce new complications for the taxpayer, and new need for keeping records. Moreover, the system proposed by the commission would confront the taxpayer with difficult choices, and the possibility of choosing a period that would later prove to be against his own interest. The proposed simpler method can be applied automatically by the central tax assessment computer, using the information for previous years stored in its memory. Moreover, it would work smoothly and fairly even when tax rates change. It should also be noted that averaging options can be very expensive in terms of revenue, particularly at a time when incomes are growing rapidly, and there must be safeguards against giving the benefits of averaging to what are simply growing incomes. 2.56 The method proposed is as follows: when the income in the taxation year exceeds the average of the taxpayer's income in the preceding four years by more than one-third, the excess income would be taxed as though it were subject to a graduated rate schedule in which the income brackets to which each rate applied were five times as wide as normal. The formula is necessarily complicated but this would not concern taxpayers because it can be applied on their behalf. Tables 11 and 12 show the application of the formula in more detail.	The brief recommends: (1) All taxpayers be allowed to average when fluctuations occur because of extraordinary events, or alternatively; (2) Taxpayers be permitted to make payments to registered retirement savings plans as proposed in the Royal Commission on Taxation for authors and professional athletes; (3) Dentists be permitted to carry forward educational expenses against future years income in the same manner as businessmen can carry forward business losses.

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	2.58 It would not be possible to bring the general averaging arrangement into effect immediately. It would be necessary to have the records of assessed income for previous years for all or nearly all taxpayers before the system could be fairly used. Until this accumulation of information reaches five years it would be necessary to use a shorter series of years, with a lower "threshold level". 2.59 A second and more serious practical problem is whether years in which there is no taxable income for one reason or another should be counted for averaging, and whether years before such a year of no income should be used. It seems unfair to permit a taxpayer to include in averaging any years in which he or she is claimed as a dependant for purposes of the married exemption. The same is true of students at school or university. Counting such years of no income, or income below the exemption limit, might well reduce tax for several years on people who have chosen to be outside the labour market and in respect of whom dependants' deductions have been granted. It is therefore proposed that a married person may use for averaging only an unbroken series of years after being claimed as a dependant by his or her marriage partner. A person under 25 years of age could use only an unbroken series of years since the last year in which he had no tax to pay. These rules are not wholly satisfactory, but no simple and practical alternative has been found. Those prevented by such rules from using more than, say, two previous years for averaging might be permitted to assume an arbitrary income of $5,000 per year in the years excluded.	

Name : CANADIAN DENTAL ASSOCIATION

Date Brief Received:

Principal Subject: Comparative Taxes in Canada and the United States

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		Pages 20 and 21 of the Brief The brief submits that a review be made of the tax burdens proposed on middle income taxpayers in both countries. The brief points out that the Association is concerned about the possible loss of qualified dentists to the United States for tax reasons.

Name : CANADIAN DENTAL ASSOCIATION

Date Brief Received:

Principal Subject: Family Unit

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
There is no reference in the Income Tax Act to a family unit.	2.5 The royal commission proposed that the family, including dependent children at home, should be taxed as a unit, using a separate schedule of rates from that applicable to individuals. The government considered this proposal carefully, as there is logic in the argument that the family, or at least the husband and wife together, is the basic spending unit. A number of other countries either permit or require the incomes of husband and wife to be added together for tax purposes. However, the commission's proposed family unit tax would have imposed a "tax on marriage"—that is, a husband and wife each having an income would together pay more tax than two people with the same incomes who were not married. This we felt to be unfair and undesirable at least for small and medium incomes. Even then, however, a wife who goes to work would have her income added to her husband's income and in effect taxed at the rates that would apply if his income were increased by the amount of her income. We are not prepared to undertake at this time such a change to a new system with a separate rate schedule. After the basic reforms proposed in the present paper are in effect it would be possible to reconsider separately a family unit basis, or a more complicated system similar to some of those used in other countries, as a further instalment of reform.	<u>Pages 21 and 22 of the Brief</u> The brief agrees with the White Paper that the "family unit concept" should not be introduced. The brief submits that when the government reviews the "family unit concept", consideration should be given to a joint return filing by husband and wife as is in effect in the United States.

Name: CANADIAN DENTAL ASSOCIATION

Date Brief Received:

Principal Subject: Child Expenses

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
There is no reference in the Income Tax Act to this type of expense.	1.33 Costs of looking after young children when both parents are working, or when there is only one parent and that parent is working, would be allowed as a deduction subject to certain conditions. This new plan is intended primarily to benefit mothers who need to work to support their families, and would be in addition to the normal exemption for children. The maximum expenses allowed would be the lower of $500 per child under age 14 or $2,000 per family. 2.7 We propose to permit deduction of the child care expenses that face many working parents today. The problem of adequately caring for children when both parents are working, or when there is only one parent in the family and she or he is working, is both a personal and a social one. We consider it desirable on social as well as economic grounds to permit a tax deduction for child care expenses, under carefully controlled terms, in addition to the general deduction for children. 2.8 Costs to be deducted would include baby-sitting expenses, day nursery care and, up to $15 a week, lodging paid at boarding schools and camps. Amounts would be deductible up to $500 per child under the age of 14, or $2,000 per family. The total allowed would also be no more than two-thirds of the earned income of the parent with the lower earned income; it would be necessary to ensure that in fact there is not a parent at home. Deductions would have to be supported by receipts and could not be claimed for payments for care of a child by a person claimed by a taxpayer or the taxpayer's spouse as a dependent relative.	Page 22 of the Brief The brief recommends that no arbitrary limit be imposed upon the amount which may be deducted. Instead, the deduction should be limited by consideration of the reasonableness of the expenses when compared to the amount of income earned by the wife.

Name : CANADIAN DENTAL ASSOCIATION

Date Brief Received:

Principal Subject: Expenses
(A) Remuneration of Spouse

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 21-2 of the Income Tax Act This section prohibits the deduction by an individual of any salary paid to the spouse.	The White Paper does not make any reference to salary paid to a spouse by an individual.	Pages 22 and 23 of the Brief The brief recommends that Section 21(2) of the Income Tax Act be repealed and that a dentist be entitled to deduct a reasonable remuneration paid to his wife.

Name : CANADIAN DENTAL ASSOCIATION

Date Brief Received:

Principal Subject: Expenses
(B) Entertainment

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 4 of the Income Tax Act This section provides that the income from a business is the profit therefrom. Accordingly expenses incurred in conducting the business are deductible. Section 12-2 of the Income Tax Act This section imposes a limit of reasonableness on expenses which are otherwise deductible.	1.35 Various fringe benefits received by employees or by the owners of businesses would be included in income for the first time. For example, an employee or owner of a business with a business-owned car available for his personal use would be required to include a minimum amount in his taxable income unless he pays the business at least that amount for the use of the car. There are other fringe benefits whose value cannot readily be measured in the hands of the recipient; for example, the use of hunting and fishing lodges, yachts and airplanes, the payment of social and recreational club dues, and the entertainment costs that are included in expense accounts. These costs would no longer be deductible to the employer. 5.9 Although the government believes that provision should be made for the deduction of legitimate business expenses that have not previously been deductible, it also believes that the present system permits deduction of certain types of expenses which taxpayers should be expected to meet out of tax-paid income. Consequently it is proposed that the Income Tax Act specifically deny deduction for entertainment expenses, the costs of attending or sending employees to conventions, and the cost of dues for membership in social or recreational clubs. This provision would not prohibit the expenditure of funds for these purposes, but it would ensure that taxpayers who wish to make such expenditures would do so out of after-tax dollars.	Pages 23 and 24 of the Brief The brief points out that dentists are not permitted to advertise and that patients are derived through referrals from patients, other practitioners and friends and acquaintances. The brief recommends that reasonable entertainment expenses as such should be allowed as a deduction.

Name: CANADIAN DENTAL ASSOCIATION

Date Brief Received:

Principal Subject: Expenses
(C) Employment Expenses

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The Income Tax Act makes no reference to this type of expense insofar as professional persons are concerned. The courts have held that expenses of travelling between one's home and place of business are personal expenses and not deductible from income.	1.32 The government has examined the deductions individuals may claim for various costs they incur, as well as differences in treatment between taxpayers who are employed and those who carry on a business or profession. The royal commission said many employees have been over-taxed because they have been denied the deduction of almost all expenses incurred in earning wages and salaries. But millions of taxpayers are involved, and a very wide range of expenses could be related to earning their employment income. These taxpayers do not keep detailed records. The government has found no practical way to permit employees to deduct actual costs as do those carrying on a profession or other business. We propose to provide employees with a general deduction to cover expenses, in addition to certain specified deductions. The amount would be 3 per cent of employment income, up to a total of $150 a year. This could benefit more than 6,500,000 persons, the great majority of them earning less than $10,000 a year.	Page 24 of the Brief The brief submits that the amount is not realistic considering expenses incurred. The brief recommends that an option should be given to maintain detailed records to support a claim for a deduction in excess of $150.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	2.12 As its second measure, the government proposes to make more provision in the law for the expenses legitimately incurred in earning wages or salaries. However, it has reached the conclusion that claims for expenses on the broad basis suggested by the commission would either impose record-keeping on millions of employees or deny them the ability to submit acceptable claims. It would also produce an impossible processing task in tax administration with inevitable long delays in making refunds. Consequently the government proposes that general limits be retained on expenses that can be deducted from employment income but that a general deduction be provided and somewhat greater recognition given to special situations where employees have to live for a period of time at a work site away from home. 2.13 It is proposed to allow a general deduction for employment expenses, similar to the option proposed by the commission but with a lower maximum. The government believes these expenses are not generally as high as implied by the commission. It would be costly, and inequitable to others, to permit substantially more to be deducted by means of a formula than was normal in typical cases. Consequently it is proposed that the general deduction allowed for expenses incurred in earning employment income be 3 per cent of gross employment income up to a maximum of $150 per year.	

Name: CANADIAN DENTAL ASSOCIATION

Date Brief Received:

Principal Subject: Expenses
(D) Moving Expenses

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The Income Tax Act does not provide for personal moving expenses. In practice, moving expenses are allowed as a deduction to determine the income of a business.	The White Paper makes no mention of business moving expenses. The proposals of the White Paper respecting moving expenses of employees are contained in the following paragraph: 2.15 A deduction would be allowed for the expenses taxpayers often must incur when they move from one job to another. The expenses of moving from one residence to another in these circumstances would be deductible provided that the taxpayer moves to a location at least 10 miles closer to his new job. The deduction would be permitted only from the income earned from working in the new locality.	Pages 24 and 25 of the Brief The brief points out that a professional man may move from one location to another for reasons other than a "change of job."

Name: CANADIAN DENTAL ASSOCIATION

Date Brief Received:

Principal Subject: Expenses
(E) Loss on Rental Property (Depreciation)

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 3 of the Income Tax Act This section states that income for a year is the income from business property and employment.	5.17 The government proposes to close this loophole in three ways. First, as mentioned in Chapter 3, a person who inherits property would for tax purposes inherit the tax cost of that property to the deceased. In this case, that would mean that the inheritor starts with the same base for depreciation as the deceased had when he died. Second, a taxpayer would be prohibited from deducting from other income a loss from holding property if that loss is created by capital cost allowance. (It is also proposed that the same restriction be placed on the deductibility of losses arising from holding property if those losses are created by a deduction of interest or property taxes. Otherwise taxpayers could reduce or eliminate the tax on their current incomes by holding large amounts of speculative property.) Finally, it is proposed that a separate depreciation class be created for each rental building that costs $50,000 or more. This would mean that there would be a day of reckoning for the owner of each large building. As each such building is sold the taxpayer would bring back into income the amount by which depreciation deducted for tax purposes exceeds the depreciation actually suffered, or conversely he would get a deduction for tax puposes immediately if he has in fact suffered greater depreciation than he has been allowed for tax purposes.	Page 25 of the Brief The brief points out that the proposal to prohibit the deduction from other income of any loss sustained from real estate caused by the deduction of capital cost allowance and interest or taxes would penalize a dentist who purchases a property in which to carry on his dental practice. The brief recommends that if the proposal is implemented, it not be applied when the rental property is used by a landlord in which to carry on his business.

Name: CANADIAN DENTAL ASSOCIATION

Date Brief Received:

Principal Subject: Retirement Pension and Retirement Savings Plans

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Sections 11-1-g, h and i, and Section 76 of the Income Tax Act These sections permit the deduction, within limits, of pension fund contributions when they arise from employment. Section 79B of the Income Tax Act This section permits a self-employed person to deduct certain payments made to a retirement plan.	2.45 For many years our income tax law has permitted contributions to approved pension funds to be deducted from income in calculating tax, and has given tax-free status to earnings on the investments of such plans. Amounts paid out in pensions or other benefits are taxable in full. In 1957, in order to make similar benefits available to self-employed persons or others not in pension plans, Parliament enacted a special section providing for registered retirement savings plans. Under such plans contributions paid into a trust fund are deductible from income for tax purposes, investment earnings on the fund are exempt from tax, and the amount accumulated in the fund must be paid out as an annuity to the taxpayer, or an annuity to him and his wife. Such annuity payments are fully taxable.	Pages 25, 26, 27 and 28 of the Brief The brief points out that the deduction limits of $3,000 for pensions and $2,500 for retirement savings plans were set in 1954 and 1957, and that consideration should be given to increasing them in the light of inflation which has occurred. The brief recommends that the limit for self-employed persons should be no less than that for employed persons. The Committee's attention is called to the statement on pages 26 and 27, paragraph 102:

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	2.52 Three other changes are also proposed. First, the savings withdrawn from these plans would be taxed at ordinary rates, even if the amounts are withdrawn at the death of the contributor. A widow would be permitted to offset or reduce this income if she contributes all or part of the proceeds to a registered retirement savings plan of her own. Second, rules are required to ensure that the trustees of a pension or retirement plan fund are liable and responsible for paying taxes arising out of its operations. This would be necessary if, for example, beneficiaries leave Canada with the assets. Third, in view of the size and rate of growth of pension and retirement savings funds, due in part to their tax-free status, it is reasonable to require that the bulk of them be productively invested in Canada. Consequently it is proposed that to qualify for the tax-free status of registered pension plans or registered retirement savings plans, these plans must invest no more than 10 per cent of their assets in foreign securities or other foreign investments.	"In the White Paper the government proposes that at least 90% of the assets of pension plans and registered retirement savings plans be invested in Canada. At the same time, it would deny to these plans the refund of corporation tax paid by the company from which dividends are received because 'rate of growth of pension and retirement savings funds is due in part to their tax-free status'. "The Association submits that the effect of the corporation tax credit will be that security purchase prices will increase because the investing public will look to yield plus tax credit in determining prices to be paid. The plans will be required to pay higher prices for securities but may not receive the same yield as other Canadian taxpayers with the effect that the government's tax-free status argument will no longer be valid."

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		Pages 27 and 28 of the Brief The Brief points out that as a result of the substantial increase in Estate taxes and Income taxes, funds otherwise available to pay death benefits will be substantially reduced.

Name: CANADIAN DENTAL ASSOCIATION

Date Brief Received:

Principal Subject: Capital Gains

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The Income Tax Act does not impose tax on capital gains.	The proposals of the White Paper respecting capital gains were reviewed on Pages 8 to 20 of the Special Study entitled "Discussion of Principal Points of the White Paper - Part 2" submitted on February 11, 1970.	Pages 28, 29, 30 and 31 of the Brief This portion of the brief refers to the proposal to tax proceeds of the sale of a principal residence, and states: (1) The revenue realized would be small. (2) Clarification should be given to the phrase "change of job" as it affects a practicing professional. (3) A sale resulting from a move to study in another locality might not qualify as a "roll-over". The brief recommends: (1) A capital gain resulting from the sale of a principal residence should not be taxed.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		(2) As an alternative, a purchase of a new residence within a reasonable time should be considered as a "roll-over". (3) The "roll-over" exemption should be available to a taxpayer who elects to continue to be a Canadian resident and who leaves Canada on a temporary basis if a new residence is purchased within a reasonable time of the return to Canada. The brief points out that a taxpayer leaving Canada is to be deemed to have sold all his assets on that day at their fair market value. The brief recommends that such a taxpayer be given the right to elect to continue as a Canadian resident and thereby avoid the tax on the deemed capital gains.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		The brief submits that the proposed taxation of goodwill is retroactive taxation as no deduction is allowed for its value on valuation day. The brief recommends that only the excess, if any, arising after valuation day should be subject to capital gains tax.

Name: CANADIAN DENTAL ASSOCIATION

Date Brief Received:

Principal Subject: Corporations and their Shareholders

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
This subject has been dealt with in Special Study No. 4 "Grossing-Up of Canadian Dividends", and is not repeated here.	See Special Study No. 4 for detailed review of White Paper proposals.	Pages 31 and 32 of the Brief The portion of the brief makes only one point. This is the difference in taxation of income and capital gains from closely held companies as opposed to widely held corporations. The brief contends this is unwarranted and unduly penalizes the shareholders of closely held corporations.

Name: CANADIAN DENTAL ASSOCIATION

Date Brief Received:

Principal Subject: Gifts and Bequests

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 111 of the Income Tax Act This section imposes tax upon the total of the taxable value of gifts made by an individual resident in Canada. The Income Tax Act does not impose tax upon bequests However, depending upon the amount of the bequest and to whom given, a duty may be imposed by the Estate Tax Act.	3.41 Special rules would be required to provide equitable treatment should a person give an asset to someone. The act now contains rules that apply when depreciable property is transferred by gift. Under these rules, the person making the gift is treated as if he had sold the asset for its fair market value and then made a gift of the proceeds. The person receiving the property is treated as if he had purchased the asset for its fair market value. These same rules would apply if other kinds of property are gifted during the lifetime of the donor.	Pages 32 and 33 of the Brief The brief states that the combined effects of Estate Duties and Capital Gains Tax can result in confiscation when an estate has to sell assets to meet Estate Duties. The brief recommends that in such cases one or the other of Estate Duty or Capital Gains Tax should not be applied.

Name:

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 20-6-c and Section 20-6-d of the Income Tax Act These sections provide that: (1) a gift of property otherwise than by will, shall be considered to be a disposition at its fair market value; (2) property received by gift bequest or inheritance shall be considered to have been acquired at its fair market value.	5.17 The government proposes to close this loophole in three ways. First, as mentioned in Chapter 3, a person who inherits property would for tax purposes inherit the tax cost of that property to the deceased. In this case, that would mean that the inheritor starts with the same base for depreciation as the deceased had when he died. Second, a taxpayer would be prohibited from deducting from other income a loss from holding property if that loss is created by capital cost allowance. (It is also proposed that the same restriction be placed on the deductibility of losses arising from holding property if those losses are created by a deduction of interest or property taxes. Otherwise taxpayers could reduce or eliminate the tax on their current incomes by holding large amounts of speculative property.) Finally, it is proposed that a separate depreciation class be created for each rental building that costs $50,000 or more. This would mean that there would be a day of reckoning for the owner of each large building. As each such building is sold the taxpayer would bring back into income the amount by which depreciation deducted for tax purposes exceeds the depreciation actually suffered, or conversely he would get a deduction for tax puposes immediately if he has in fact suffered greater depreciation than he has been allowed for tax purposes.	

Name: CANADIAN DENTAL ASSOCIATION

Date Brief Received:

Principal Subject: Investment Income of Clubs and Other Non-Profit Organizations.

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 62-1-i of the Income Tax Act This section exempts from tax the income of clubs and non-profit organizations, provided they are not operated for the personal profit of proprietors, members or shareholders.	5.54 The present law contains a provision—section 62(1)(i)—that exempts from income tax social, recreational and service clubs, societies and associations which operate on a non-profit basis. (This provision does not cover registered charities which are exempted under other paragraphs.) The government does not propose to change the exempt status of the basic functions of these organizations, but when they accumulate investment portfolios, it believes that the investment income therefrom should bear income tax. Therefore it is proposed that the investment income of organizations which are covered by section 62(1)(i) be subjected to the corporation tax.	Pages 23 and 34 of the Brief The brief submits that this proposal would produce little revenue, while its effects would be to curtail the useful function of the organization.

APPENDIX "J"

St. John's Cemetery on the Humber

TORONTO, ONTARIO

CEMETERIES AND WHITE PAPER PROPOSAL 5.54

St. John's Cemetery on the Humber believes that White Paper proposal 5.54 would adversely affect the care and maintenance of all non-profit cemeteries except those operated by a church, religious organization or municipality.

We have been advised by the Department of National Revenue that only the latter cemeteries are considered to be charities for the purposes of Section 62 of the Income Tax Act. Other non-profit cemeteries will no doubt continue to have their "basic functions" exempt from income tax under s. 62(1)(i). However, proposal 5.54, if enacted, would subject to corporation income tax the entire investment income from the funds set aside by non-profit cemeteries for the care and maintenance of cemeteries except those operated by a church, religious organization or municipality. It is submitted that such taxation is contrary to sound public policy.

St. John's Cemetery on the Humber

St. John's Cemetery is, we believe, the oldest burying ground in Metropolitan Toronto--the first person buried therein died in 1801. It has been a family cemetery ever since, and has been maintained as such by descendants of the original settlers--John and Sophia Denison.

St. John's Cemetery on the Humber is a small non-commercial, non-profit corporation without share capital. It is presently exempt from income tax under s. 62(1)(i) of the Income Tax Act. It cares for the graves and the six acre burying ground known as St. John's Cemetery on the Humber, which is in the Borough of York on the east bank of the Humber river immediately south of Denison Park which is in the former Town of Weston.

Income for the upkeep has come from funds paid into the Supreme Court of Ontario in the 1890's, from the occasional bequest and from donations which have

been settled by trust deed with the Royal Trust Company. Deficiencies have been met by "passing the hat" among the interested. No charge is or can be made for burial plots.

If the subject proposal is enacted, half of the investment income of some $2,300 per annum would be absorbed by taxation and the maintenance of the graves would suffer since few members of the family are able to increase their giving to make up a loss of this dimension.

Other Cemeteries Would be Affected

The position of St. John's Cemetery is not unique. According to the Government of Ontario there are over 2,800 non-profit cemeteries in Ontario alone. We are sure that a great many of these are not operated by a church, religious organization or municipality and would be hurt by this proposal. Their standards of care could deteriorate to the point where the municipalities or province would have to maintain them.

Inequities

The proposal contains the following inequities:-

(a) The income set aside for the care of graves in a cemetery run by a church, religious organization or municipality would not be taxed, while the income of other non-profit cemeteries would be cut in half.

(b) The income from the perpetual care funds of commercial cemeteries would presumably continue to have the necessary upkeep expenses deducted before tax would be levied. By contrast, proposal 5.54 does not contemplate such a deduction for non-commercial cemeteries.

(c) Amounts paid for plots would no doubt continue to be a deduction from estate values for the purpose of death duties. Amounts bequeathed to private cemeteries would continue to attract death duties. In other words, income tax would be levied on the gross income of private

cemeteries which is derived from already taxed bequests. This is double taxation as opposed to single taxation of some cemeteries and no taxation of others.

5.54 is Not a Part of a "Package"

The proposal contained in Paragraph 5.54 is not a part of a package of tax reforms. No other proposal in the White Paper is dependent upon it. To apply it to funds set aside for burial grounds would not, we believe, produce any significant revenue.

Recommendation

It is respectfully urged that proposal 5.54 be not applied to the income from funds set aside for the care and maintenance of graves and cemeteries. The exemption should be in broad terms and include funds held by non-profit cemeteries as well as what in Ontario are known as "perpetual care funds".

In the alternative, we urge that non-profit cemeteries be declared to be charities for the purposes of the Income Tax Act and so removed from the scope of Paragraph 5.54.

Respectfully submitted,

ST. JOHN'S CEMETERY ON THE HUMBER,

By: Martin Dunsford
Martin Dunsford, President
407 St. Clements Avenue
Toronto 12, Ontario

By: John H. Martin
John H. Martin, Sec'y.-Treas.
112 Boulton Drive
Toronto 7, Ontario

February, 1970

APPENDIX "K"

NAME: ST. JOHN'S CEMETERY ON THE HUMBER

SUBJECT: Investment Income of Clubs and other Non-Profit Organizations

Analysis of Appendix "J" by Senior Advisor

This brief is submitted by St. John's Cemetery on the Humber on behalf of itself. It indicates that there are over 2,800 such non-profit cemeteries in Ontario, many of which are believed to be in a similar situation, and would be hurt by the proposal to impose corporation tax upon the investment income of such organizations.

The brief refers to:

(a) The difference in treatment afforded to a church cemetery which can qualify as a charitable organization and that afforded to a non-profit cemetery which cannot qualify as a charitable organization.

(b) The reduction of income received from perpetual care funds of a commercial cemetery by necessary upkeep expenses and the taxation of the investment income of a non-profit cemetery with no deduction being allowed for upkeep expenses.

(c) The fact that the cost of a plot may be deducted from estate values for purposes of death duties while bequests to private cemeteries continue to attract death duties.

Members of the Committee will observe that this brief recommends:

(1) That the proposal to tax investment income of non-profit organizations should not be applied to the income from funds set aside for the care and maintenance of graves and cemeteries, including "perpetual care funds" or, alternatively;

(2) That non-profit cemeteries be declared to be charities for purposes of the Income Tax Act.

There is attached the usual summary of present tax laws, White Paper proposals and principal points of the Brief.

Name : St. John's Cemetery on the Humber

Date Brief Received:

Principal Subject: Investment Income of Clubs and other Non-Profit Organizations.

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 62-1-j of the Income Tax Act This section exempts from taxation the income received by a club, society or association which is operated exclusively for social welfare, civic improvement, pleasure or recreation, or for any other purpose other than profit so long as no part of the income is available for the personal benefit of any proprietor member of share-holder.	The proposals of the White Paper respecting investment income of clubs or other non-profit organizations are contained in the following paragraphs: 4.60 The government does not propose a refund to pension plans and other tax-free entities of the corporate tax paid by the corporations from which they receive their dividends. It considers that tax-free status of the investment income of the pension plan, including capital gains, is sufficient tax concession to these entities. 5.54 The present law contains a provision—section 62(1)(i)—that exempts from income tax social, recreational and service clubs, societies and associations which operate on a non-profit basis. (This provision does not cover registered charities which are exempted under other paragraphs.) The government does not propose to change the exempt status of the basic functions of these organizations, but when they accumulate investment portfolios, it believes that the investment income therefrom should bear income tax. Therefore it is proposed that the investment income of organizations which are covered by section 62(1)(i) be subjected to the corporation tax.	Page 2 of the Brief The brief sets out the inequities in the treatment afforded to non-profit cemeteries as compared to church cemeteries and commercial cemeteries. Page 3 of the Brief The Brief points out that no other part of the "package of tax reforms" is dependent upon the taxation of the investment income of non-profit organizations. Pages 2 and 3 of the Brief The Brief points out that half the investment income of the organization would be absorbed by taxation, and that the taxation of such funds would not produce any significant revenue.

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		Page 3 of the Brief The Brief recommends that the proposal to tax investment income of non-profit organizations (1) not be applied to non-profit cemeteries or, alternatively (2) that non-profit cemeteries be declared to be charities for purposes of the Income Tax Act.

APPENDIX "L"

GOVERNMENT WHITE PAPER : "PROPOSALS FOR TAX REFORM"

SUBMISSION TO THE STANDING SENATE COMMITTEE

ON BANKING, TRADE AND COMMERCE

CONTENTS

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GOVERNMENT WHITE PAPER: "PROPOSALS FOR TAX REFORM."

SUBMISSION BY THE CANADIAN ASSOCIATION OF UNIVERSITY TEACHERS, 233 Gilmour Street, Ottawa 4.

1. Introduction:

The two areas of the White Paper that particularly concern the university teacher are:

Paragraphs 1.32 and 2.10 - Deductions for employment expenses.

Paragraphs 1.37 and 2.24 - Proposed taxation of fellowships, scholarships, bursaries and research grants.

2. Deductions for Employment Expenses:

The special case of the University Teacher as Practising his Profession.

In a submission by this Association to the Royal Commission on Taxation, a strong plea was made for the treatment of university teachers as highly skilled, professional persons, practising their profession in the only way possible for them i.e. as members of the academic staff of a university. It is only certain professors with professional diplomas - architects, lawyers, chartered accountants - who have any alternative means of practising their profession. A professor of English or French or History, for example, can carry out his main objects of teaching and research only by joining the academic staff of a university - he has to become an employee. He cannot run a university either on his own or in partnership.

3. The meaning of "Business", sec.139(1)(e) of Income Tax Act.

In these circumstances it seems reasonable that the significance of "business", in section 139(1)(e) of the Income Tax Act, should be expanded to cover specifically the case of the university teacher as an employee. *We have been officially notified that, in the United States, "business" includes the performance of business services by an employee. Certainly this seems justifiable where, as in the case of the university teacher, his career is dedicated (a) to educating other adult persons for their careers and (b) to carrying out research in the area of his particular discipline. The point is that, to quote the submission to the Royal Commission, "in their unique professional circumstances as employees, the essence of the activities of university teachers is the maintenance of their scholarship." They may, from time to time, write books and so earn some non-employment income, but in general most of their income will come from their necessary employment.

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* See U.S. Treasury Dept. letter, Jan. 2, 1963, Exhibit A.

4. Distinctive Position of the University Teacher.

This question of practice in a profession is so fundamental that it must be pursued further. The distinctive characteristic of practice in a profession is the exercise of personal skills in "some branch of learning or science" (Concise Oxford Dictionary). The practising professional man must have autonomy; he must be able to make his own decisions without being subject to the dictates of an employer. Holding himself out as possessing the skills required for the particular subject that he teaches, he must make decisions for which he must accept full responsibility. Or if he shares the responsibility with other faculty members, it is much as if their association with him is that of partners in a professional practice.

5. The University not a "Master".

The possession of these qualities distinguishes the university teacher from other employees. The university as employer does not fit the classification of "master" in the normal relation of master and servant. The employment has no aims of profit making. It exists simply to enable highly skilled persons, who individually have no means of imparting their know,edge, to join together in faculties for educative purposes.

6. The Governing Body - Administrative not Academic.

The governing body, the university teacher's legal employer, is largely made up of laymen with no responsibility or qualification for making academic decisions. It exists essentially to provide the administrative means for carrying out the university's academic purposes.

7. The Royal Commission and Employment Expenses.

The Royal Commission placed first emphasis on the requirement that, to be deductible for income tax, expenditures must be "reasonably related" to the gaining of income.* "The positive side of this rule is that all expenditures reasonably related to the gaining or producing of income should be deductible, the negative side is that any expenditures not so related should not be deductible." Believing that (p.86) "the best way to achieve an equitable treatment of expenses related to employment is generally to apply the same rules to these expenditures as are to be applied to business expenditures," it recommends withdrawal of the present prohibition on deductions from employment income. Its suggestion of a maximum deduction of $500, on the basis of an optional stan-

* Report of the Royal Commission on Taxation, Vol.3, p.83. (cont'd.

dard deduction of 3% of employment income, is a recognition of the administrative problems involved. But it does also recommend (p.86) "that the employee should be entitled to substantiate a larger deduction if he can do so." It is the contention of this submission that the university teacher, as a highly skilled, professional person carrying out his professional duties in the only way possible for him, should be entitled to deduct, without limit, reasonable expenses connected with the university employment.

8. The Costs of Academic Practice to the University Teacher.

The university teacher must constantly make decisions and take actions, in the course of his teaching and research, which will cost him money which will not be reimbursed. Like any other professional man he may be expected to incur those costs which he deems necessary for the maintenance of his professional status. This was never more true than it is in the rapidly changing conditions of the present day. Without any special requirement in his contract of employment,the university teacher is expected to incur the costs of keeping himself efficient and to decide for himself what those costs must be.

9. Sec.11(10)(a) of the Income Tax Act Concedes the Principle.

The recognition of professional membership dues, under sec.11(10(a) of the Act,as deductible from employment income, concedes the validity of the claim that expenses necessary for maintenance of professional status should be deductible for tax purposes. The removal, in 1957, of the initial restriction that payment of the professional dues must be specified in the employment contract recognised the validity of accepting the professional decision of the employee. But the deduction should clearly not be restricted to professional dues.

10. Professional Expenses that should be Deductible.

Comparable expenses that should be deductible on like grounds include the following:

(1) Subscriptions to professional journals;
(2) Subscriptions to Learned Societies;
(3) Costs of sabbatical leave for research or teaching purposes;
(4) Costs of books purchased for teaching or scholarship purposes;
(5) Costs of attending meetings of Learned Societies;

(6) Costs of research work not reimbursed;
(7) Costs of summer school refresher courses;
(8) Costs of robes, gowns, lab. coats;
(9) Costs of study in the university teacher's residence, as essential for the proper performance of his professional duties;
(10) Costs of travel and extra living expenses. (cont'd)

through summer employment as visiting professor for teaching and/or research in another university.

11. A Specific Case Cited.

Letters are constantly being received by the Association from members who find themselves hard hit by the tax requirements, at the very time when their dedication to their profession induces them, often at a reduced salary, to take sabbatical leave and incur heavy travelling and living costs for the carrying out of research. One such letter, received in late December, 1969, states the position as follows:

"The financial aspects of taking a sabbatical are somewhat horrifying. In my case, even if I obtain the most rewarding fellowship that is available, between my wife and myself we shall have a minimum loss in income, over the year, of $6,000. Additionally we have been told that there is no hope of obtaining an economic rent for our house and we must accept a loss of approximately $2,000 over the year. We will be spending the sabbatical in London, England, and inquiries indicate that, if we wish to be reasonably certain of decent educational standards, for at least our boys, then we will have to meet a further additional expenditure of some $1,500. Added to that I will have to carry the pension commitments as though I were receiving full salary and all other commitments that we have, that are based on full salary, have to be carried. There are other losses to be met which are less evident, connected with the necessity of storing possessions, including cars. We will also have to pay a high rent, since we will need furnished accommodation, which seems to command a premium.

The essence of this is that the direct additional costs of taking a sabbatical may run close to $10,000 a year."

This professor is, of course, primarily concerned with the proposals of the white paper to tax the fellowship, by which the sabbatical is financed. But even if the fellowship is taxed, the present law, and that proposed by the white paper, allows virtually no deduction of costs from the financing fellowship grant, and he estimates the cost to him at $10,000 for the year. In such circumstances the penalising tax requirements tend simply to stop the very research work by which a university not only justifies its existence but contributes to the general good of mankind.

12. Costs of Study in Taxpayer's Residence.

It is an established principle that a professional man may deduct, from non-employment income, reasonable costs for the use of his study in his own residence. For the reasons already stated, the university teacher, as a professional man, should be regarded as carrying on his profession in the constant use of his home study for the preparation of lectures and the carrying on of his research. In the case of many university teachers this is quite a considerable continuing expense.

(cont'd.)

13. In the United Kingdom the Association of University Teachers, many years ago, made this very point in its submission to the Royal Commission on the Taxation of Profits and Income. As a result, if the university teacher can show the necessity for the use of a separate room as a study in his residence, in the performance of his duties, he is allowed to claim a deduction from his employment income for a reasonable portion of the rent (or annual value) and property taxes applicable to the room, and also for the incidental costs of lighting, cleaning, heating etc. The amount of the deduction will depend on the extent of use of the room in the performance of the university teacher's duties and for other purposes, respectively (See Exhibit B, Association of University Teachers, C72a, October 1959)

14. Costs of Attending Meetings of Learned Societies.

In view of the White Paper's proposals, in para. 5.9, to deny deduction for the costs of attending conventions, even in the case of taxpayers who are practising their profession, particular stress must here be placed on the distinctive circumstances of university teachers. In our submission to the Honourable Mitchell Sharp, on the Report of the Royal Commission on Taxation, we stated the position as follows:

"Convention Costs

The same considerations apply to convention expenses, including all the costs of transportation, meals and residence. It is probably not well enough understood that there are great differences, from university to university, in the financing of these expenses. Some universities are well able to defray these costs and do so for all academic employees, sending them to conference and committee meetings across Canada quite freely, at university expense. In other cases, though a good teacher will feel it his duty to attend the meetings of the Learned Society of which he is a member, he can actually attend only at his own expense, since he has no university budget available to him.

This does, in fact, prove to be quite a costly expense for university teachers, particularly where they are members of professional bodies, as in the case of doctors, lawyers, chartered accountants, architects, or engineers. It is essential that the reasonableness in principle of the claims for deduction of these costs, on a really liberal basis, shall be accepted by the Department, the costs themselves being supported by satisfactory vouchers.

In this connection this Association supports the minority recommendation of Commissioner Beauvais (Vol. 1, pages 58/9) against the fixing of specified limits for conference registration fees and daily rates of entertainment expenses, meals and lodging."

15. Costs of Travel and Extra Living Expenses through Summer Employment.

This Association is frequently presented with appeals from university professors who travel to universities other than their own, to teach in summer schools or carry out research. In the pressures of demand in the present day such summer teaching

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seems likely to grow very rapidly. It includes the offering of short periods of full-time study, preferably in residence on the campus, for students such as school teachers or, perhaps, chartered accountants-in-training, whose main studies may have been done on a part-time, or even a correspondence, basis.

16. The point is that the visiting professors are filling a very real need. Yet at present, unless the university specifically reimburses them for their costs of travel and their extra living expenses, these costs have to be made good out of their summer school remuneration which is, nevertheless, subject to full taxation. For the travelling and living costs are regarded as living expenses and are disallowed as deductions for income tax.

17. A specific case, cited by the Association to the Royal Commission on Taxation, is that of a Professor of History at Memorial University of Newfoundland who taught, in the summer, at the University of Saskatchewan, receiving $450 remuneration. His costs of getting to Saskatchewan and living there were $381, including $157 for meals. Excluding this as personal expenses, the remaining $224 was for travelling and rent, which duplicated the living costs of the professor's home in St. John's. On a net income of $226, therefore, for a month's summer lecturing, the amount of tax paid was $170, based on the gross income of $450.

18. It seems ridiculous, in such a case, to treat the travelling expenses as initial costs of getting to the place of employment under a "master and servant" contract, regardless of the length of the contract. The absurdity is seen when it is considered that the $224 for travelling and rent might have been reimbursed by the university, a separate cheque being paid for the remaining $226, as lecturing fees. In this case only the latter would have been taxed as income. Logically, however, even then, presumably, the $224 expenses might have been added back and taxed, as a benefit received, under section 5 of the Income Tax Act.

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19. It would be wholly equitable, in any case, to avoid dependence on the manner of payment by the university, for a provision to be made in the Act for deduction of the travelling and duplicated living expenses. If such a professional teaching contract were defined by the Act as satisfying the definition of "business", as in the United States, the expenses would be deductible and the demands of equity satisfied. Here, if anywhere, is a case which would justify specific deduction, as recommended by the Royal Commission on Taxation in Canada, in addition to the maximum deduction for all employees. (See para. 7 above). By undertaking such summer lecturing or research, away from his own campus, the university teacher gains the broad experience which makes him a better professional man, and he is encouraged to do it by his own university. He should not be penalised financially in the process.

20. Conclusion on the subject of Allowable Deductions. In para. 1.32 of the White Paper it is stated that the "government has found no practical way to permit employees to deduct actual costs as do those carrying on a profession or other business." The resulting proposal of paragraphs 1.32 and 2.10 to allow a general 3% deduction from employment income, up to a maximum of $150 a year, clearly aims at avoiding the administrative problem and is meant for the 6,500,000 persons most of whom earn less than $10,000 a year, as the White Paper indicates. In recommending a much higher maximum deduction of $500 the Carter Commission recommended that each taxpayer be entitled to substantiate a larger deduction. This Association urges the adoption of this recommendation. Alternatively, it recommends extension of the meaning of "business", in section 139(1)(e) of the Income Tax Act, to cover specifically the teaching and research done by a university teacher, as a faculty member of a university.

The recent Exchequer Court decision in Alexander v. Minister of National Revenue, as discussed by Gwyneth McGregor, editor of the Canadian Tax Journal of the Canadian Tax Foundation, seems very much to the point. The president of the court, Mr. Justice Wilbur Jackett, stressed the distinction between an employee, subject to a contract of service, and a self-employed

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man under a contract for services. The appellant, in this case, was a radiologist under contract to a hospital. Although he carried on his work "exactly as he would have done if he had been an employee", his administrative functions were similar in character to those performed by medical chiefs and practising doctors who were not employees. Furthermore, he was obliged to provide "coverage" for his work whether or not he could do it personally. The court concluded that his was a contract for services, so that his travelling expenses on hospital business became deductible for tax purposes, even though they included travelling between his home and a university in another town for regular seminars to keep up with developments in the field of radiology.

21. Taxation of University Scholarships.

The white paper proposes, in paragraph 2.24, to tax university research scholarships, bursaries and grants for research.

Such grants are at present non-taxable if they are not associated with personal services. The Canadian Association of University Teachers recognises the concern or preoccupation with equity which prevails throughout the white paper. From this point of view it is possible to conclude that university scholarships like the stipends paid to members of the Commons and Senate should be taxed exactly like any other form of revenue. It would seem, however, that the Government has made only a superficial analysis of the matter ignoring the underlying factors which have justified and, in our opinion, continue to justify the exemption accorded to research scholarships and university grants. We give the following as a fundamental case to justify continued exemption.

1. Exemption as an Allocation for Expenses

When university grants are made to allow a university professor to follow studies or research in another university or another town, there are always a number of expenses which the Minister of National Revenue classifies as personal expenses but which, in reality and in equity, are truly expenses directly attributable to the grant received. Suffice it to mention the expenses of moving and changing residence. Similarly, the fact

*Reported in the Financial Post, Feb. 7, 1970, p.12.

(continued...

of pursuing studies or research in another town results, for the recipient of the grant, in extra expenses even if they may seem to be personal expenses which, nonetheless, are directly attributable to the fact of fulfilling the conditions of the grant. Take, for example, the frequent situation of a professor who incurs losses on sub-letting his lodging or, perhaps, on letting his own residence in his absence, when often he must pay a much higher rent in the city in which he temporarily carries on his studies or research. Studies or research also necessitate buying books and equipment, costs which the government refuses to recognise as existing or necessary. If it is logical not to recognise all these expenses as deductible when a grant is accepted as non-taxable, it seems to us equally logical, if it is intended to tax such grants, not to close one's eyes to reality but to recognise that there are costs and expenses directly attributable or associated with these grants. It should be added, perhaps, that if fiscal equity justifies the taxing of such grants the government should not mention the equity only when the final results have the effect of increasing its revenues, but it should also follow the principles of equity when they have the effect of diminishing its revenues. Unhappily the impression given by the white paper is contrary to this. It cannot be equitable to tax the grants without allowing deduction of the expenses which are bound to be incurred. Since the white paper proposes not to allow deduction of the of the expenses it should not propose to tax the grants.

2. Source and Utilisation of University Scholarships

University scholarships for study or research are at present derived either from government organisations or from private organisations which, for the most part, are not subject to tax. Whatever the source, whether public or private, the funds destined for studies or research are necessarily limited and could not be rapidly increased. Following the taxation of scholarships and grants they would have to be increased to take account of the tax if the same objectives were to be reached. Before government organisations adjusted themselves to this new way of looking at things, there would of necessity be a lengthened period during which the available funds would not be increased

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and consequently there would, in effect, be fewer scholarships or grants. It is precisely this period of transition that frightens the members of our Association. It frightens them all the more because Canada is giving evidence of being markedly behind in the matter of research. To the extent that the scholarships and grants come from provincial authorities, subjecting them to taxation transfers funds from provincial to federal authorities. The provincial authorities necessarily have limited resources, with a result that could be termed a reduction of investment in education and research. An almost identical reasoning applies when scholarships and research grants come from private organisations or foundations.

3. Nationalism and Neutrality on an International Scale.

Considering that the tax on income is paid by all residents, we must conclude that subjecting scholarships for study and research to Canadian taxation puts a permium on expatriation, encouraging the pursuit of study and research abroad rather than in Canada. From a like point of view, the scholarships for study and research offered by foreign countries are not taxed in those countries, a consideration which makes all the more attractive any sojourning and prolonged periods of research abroad. This is not a political objective which seems to us to be justified, considering the necessity for developing our teaching and research institutions in Canada.

In the United Kingdom the situation is the same as at present in Canada, but the balancing of advantages would be easily upset with the taxation by Canada of scholarships for study and research. The problem could become all the more serious if the government intends to submit the Canadian scholarships granted to non-residents to a tax of fifteen (15) or twenty-five (25) percent. The fiscal system, more precisely the treaties or conventions signed by Canada, would not be neutral, in the sense that they would discriminate against the country in which the studies or research are pursued, a discrimination which has no economic foundation.

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In the United States, section 117 of the Internal Revenue Code expressly anticipates the exemption of scholarships for study and research as well as amounts received to defray those expenses of travel, research, clerical assistance, or equipment which are incidental to such scholarships for study and research.

22. Professors and Teachers from Abroad Temporarily Teaching in Canada.

In paragraph 2.26 the white paper announces its intention to remove the exemption granted hitherto, under conventions with Britain, the United States and other countries, in respect of salaries paid to professors and teachers from abroad for teaching in Canada for up to two years. It is stated that, in some cases, tax may not be payable in the country of normal residence. While Canadian exemption may, in itself, not be justified on logical grounds, it must be remembered that considerations of costs of removal, house rental, and travelling expenses must apply here equally with the cases of scholarships for study and research already cited. While section 2.15 of the white paper proposes a deduction for moving expenses, which would apply in such circumstances, all would depend on the liberality of interpretation of the expenses, in such a case.

In general the attraction of such teachers from abroad may well be considered of great benefit to Canada, for its importation of new ideas and the broadening and modernising of our teaching concepts. Certainly the removal of this exemption, together with the proposed taxation of scholarships and research grants, will strengthen the impression that Canada is reversing its traditional policy of welcoming new ideas in education and encouraging Canadians to do research abroad. Its reference to "the present scale of salaries of professors and teachers" makes all the more evident the failure of the white paper to take proper account of the extra expenses necessarily incurred during the period of temporary expatriation.

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23. Pension and Retirement Savings Contributions.

In paragraph 2.52 the white paper proposes "that to qualify for the tax-free status of registered pension plans or registered retirement savings plans, these plans must invest no more than 10% of their assets in foreign securities or other foreign investments." This suggestion is of particular concern to this association as is evident from the following extract from its submission of October, 1967, to the Honourable Mitchell Sharp, then Minister of Finance, on the recommendations of the Royal Commission.

"Under the present Act, such distinctive plans as the Teachers Insurance and Annuity Association (T.I.A.A.) and the College Retirement Equities Fund (C.R.E.F.), in the United States are not open to individual Canadian residents, under the registered retirement savings plan, because neither of them does business in Canada. However, Canadian universities may, and a number of them do, authorise the use of T.I.A.A. - C.R.E.F. annuity contracts within their normal registered pension funds. This applied, for example, to the University of British Columbia up to June 30, 1967, and it applies still to Victoria University, B.C., and some others. Yet if these universities continue to allow their teachers this option, the planned integration of corporation and personal taxes (a generally acceptable and fundamental proposal of the Commission) will see dividends received from CREF, by the Canadian trustees, not qualifying for the 50% tax credit, thus considerably reducing the accumulation in the fund. For virtually all the investments of these funds are non-Canadian and the Commission proposes that not more than 10% of the income of a registered fund shall be from foreign sources. Hence it would seem that TIAA - CREF and other such plans could no longer be adopted, even for a university's normal retirement plan.

(continued)

Since the TIAA - CREF plan would be deemed non-registered, any benefits received, in excess of the taxpayer's own contributions, would be taxable in full, subject to a foreign tax credit for tax withheld. The past election to invest in these funds has been made in order to obtain the benefit of higher dividends from outside Canada, particularly from the United States. Quite apart from preventing future investments abroad, it would be grossly inequitable to penalise the holders of interests in these funds, by forcing them to sell any foreign securities. TIAA - CREF would no longer be available for pension investments in Canada." A footnote pointed out that a particular attraction of the CREF, with its variable annuity geared to the cost of living, was that it afforded a hedge against inflation, while insurance companies in Canada were only just beginning to offer such variable annuities.

Information now received from the president of the Faculty Association of the University of British Columbia indicates that nearly one-quarter of its membership is still on TIAA. Now the white paper proposes to implement the recommendations of the Royal Commission and, in effect, ban the TIAA- CREF, and all such investment of funds outside Canada, not only for the registered retirement savings plans, as at present, but also for registered pension funds themselves. The implications of this proposal, to the detriment of the large number of university teachers whose pension funds are already invested in these United States institutions, which are concerned solely with pensions for university teachers, are extremely serious. It is clear that, at the very least, university teachers already on the TIAA - CREF plan should be allowed to continue their investment, while retaining all the exemption benefits under the Income Tax Act.

It is also to be noted that the white paper proposes to go further than the Royal Commission, which proposed only to withhold from pension funds the 50% tax credit for dividends received from <u>non</u>-Canadian corporations. Paragraph 2.47 of the white paper "believes that the tax free trusts for retirement plans should not be entitled to the credit for corporation income tax proposed for dividends on shares in <u>Canadian</u> corporations.

(cont'd.)

Freedom from tax on dividends and interest and capital gains should be sufficient." This is, surely, far too sweeping a statement. For employees it must be remembered that the exemption limits for contributions to pension and retirement savings funds combined have, for over 20 years, been fixed at a maximum of $1,500 per annum, with no regard whatever to the drastic effects of inflation. Neither the Royal Commission nor the white paper proposes to do anything about inflation. How, then, can it be considered equitable to disallow to pension funds the tax recovery rights of other recipients of dividends from Canadian corporations? This association urgently recommends that pension funds in receipt of Canadian dividends be given the same right of tax recovery as other Canadian recipients, in accordance with the recommendations of the Royal Commission. The fact that payment of tax on such dividends will be deferred, in the case of pension funds, does not mean that it will not ultimately be paid and there is no logical justification for abandoning, in this case, the planned integration of corporate and personal income taxes so fundamental to the proposals both of the Royal Commission and the white paper.

The implication, in paragraphs 2.49 and 50 of the white paper, that, at some future time, the limits for tax-free savings funds may be set rather in terms of the benefit provided on retirement than of the individual's annual contribution to the fund, raises the question of the amount of any such limit, having regard to the problem of inflation - more urgent today than at the time of the Report. This brief therefore concludes with the following extract from the association's submission of October, 1967, to the Honorable Mitchell Sharp, then Minister of Finance:

"This brief does not wish to dispute the Commission's sound reasoning in favour of a maximum target figure for the taxpayer's retirement pension, rather than the present maximum annual contributions by employer and employee. However, it does emphatically wish to contest two points:

(1) the unimaginatively low maximum of *$12,000 set for the target pension,

(2) the failure to provide for any automatic adjustment of the maximum, from year to year.

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* See the address on Deferred Income, by Professor Robert M. Clark, Dept. of Economics, University of British Columbia: Report 1967 (April) Conference, Canadian Tax Foundation, pp.278-286.

(cont'd.)

"Inflation and the Ceiling for Tax-free Pension Accumulation.

(1) The Commission recommends (Vol.3, p.423) that the maximum allowable benefits for all registered income plans, for any tax unit, be the equivalent of a single life annuity, with a guaranteed term of ten years, of $12,000 a year for an individual, payable from age 65. It points out that the $12,000 limit refers only to the tax benefit, and does not prevent a larger accumulation for retirement. However, the tax benefit is of decisive importance when it is a question of giving the incentive for accumulating income for the years of retirement at the cost of a present sacrifice. As a maximum for tax exemption, $12,000 is surely far too low, even considered as an absolute sum, without reference to changing cost of living. The immediate effects of imposing such a limit would be felt by those at present under middle-age, but the long-term effect would be serious for all taxpayers.

It is noted that Commissioner Grant dissents emphatically from the $12,000 limitation (Vol. 1, p.110), pointing out that 'it would mean a cutback in some of the Registered Retirement Income Plans now in existence, in both current and past service, and would fail to meet pension requirements for many in business and the professions, where creative capacity must be recognized." Commissioner Beauvais, also dissenting, states that present departmental practice allows a limit of $40,000.

This brief supports the statements of Commissioners Grant and Beauvais, and urges that, if the existing system is to be changed, to avoid overlapping of plans, then the limit of retirement income to be provided for by tax-free contributions should be at least $20,000 per annum."

"(2) Correction for Inflation

A factor to be taken very seriously into account, with particular regard to the accumulation of retirement income, is the eroding effect of inflation.

If the history of the remuneration of university teachers over the past 20 years be analysed, it will be found that where, in 1948, the annual salary of a full professor in a reputable university was about $5,000 or less, the figure at the beginning of the full professor's scale today is about $16,000 - in 20 years the salary has more than trebled. (continued)

"Is there any reason to think that the same trebling may not occur again in the next 20 years? If not, how can this factor possibly be ignored, in so far as it results from inflation, when providing for the post-retirement income of 20, 30 or 40 years hence?"

"The Commission states carefully and in detail its policy in regard to inflation. It has a great fear of upsetting the 'automatic stabilisers that are built into the present tax-expenditure system'. It prefers, therefore, to ignore the effects of inflation but urge the government periodically to 'review the tax system and its transfer payment programmes to ensure that those on low, fixed incomes share in the fruits of Canada's economic growth.' The trouble is that this leaves things to the decision of a government that is subject to countless pressures, with the constant need to deal with them ad hoc, according to the relative urgencies of the moment. Changing price levels through inflation can cause great havoc and suffering among those on fixed incomes, before the government comes to the point of changing the tax credits to relieve such suffering. The 1950s were not years of seriously growing inflation, yet retired university teachers on fixed incomes suffered quite considerably through the falling value of money. It cannot be right to deal with the problem of inflation on such an arbitrary basis.

"The fact remains that there are reliable indices to compensate for changes in the cost of living. The accountancy profession as a whole has not yet accepted the necessity for using any index to correct accounts for inflation. Nevertheless, there are many leading professional accountants who advocate such correction, on the grounds that any resulting inaccuracy would be infinitely less than the inaccuracy of doing nothing. The Accounting Research Study No. 6 of the American Institute of Certified Public Accountants, (speaking for the individual researchers, it is true, and not for the Institute itself), gives serious consideration to the automatic correction of accounts by use of indices such as the Implicit Price Deflator of the Gross National Product.

(continued)

"For application to the pension figure the most suitable index would be one *which takes into account the annual per capita expenditure on consumer goods and services, based on the reliable records of the Dominion Bureau of Statistics. This should be used to correct the pension fund ceiling from year to year.

"The Commission accepts an annual change of from 1½% to 2% in the consumer's price index as normal in the present age. At this rate it is evident that a retired university teacher, who began receiving a fixed annuity of $5,000 per annum in 1957, (not by any means an unrealistically low figure), would today be receiving in effect little more than $4,000 in terms of 1957 dollars. Or it may be said that the income needed in 1967, to be equivalent in 1967 dollars to the $5,000 of 1957, will be $6,000. And this, it must be noted, brings a married taxpayer who is fortunate enough to have an income with the built-in compensation that has raised it from $5,000 to $6,000, in the ten year period, to the very beginning of the $4,000 to $6,000 bracket, with the tax rate increased from 22% to 26%. Evidently not only are inflation profits at present subject to tax but, with our progressive rates of tax, they may well be taxed at higher rates. It is of paramount importance that specific annual adjustments by index should be made, to ensure that accumulating pension funds are commensurate with the changing value of money, from year to year. This cannot be left to arbitrary intervention of the government."

At a time when the annual rate of inflation is about 5% or more these observations on the eroding effects of inflation need to be given all the more serious consideration, in the interests, above all, of the pensioner with fixed income.

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* Ibid p. 286.

EXHIBIT A

U.S. TREASURY DEPARTMENT
Internal Revenue Service
Office of International Operations
Washington 25, D. C., USA

In reply refer to:
CP:IO:A:R:EC

Professor Kenneth F. Byrd
Purvis Hall, 1020 Pine Avenue West
McGill University
Montreal, Quebec, Canada

Dear Professor Byrd:

This refers to your letter requesting information about the deductibility of various expenses incurred by university professors.

Under the provisions of the Internal Revenue Code a taxpayer who is engaged in business is allowed to deduct all the ordinary and necessary expenses incurred in the operation of that business. The term "business" for this purpose includes a profession or performance of services as an employee.

Section 162 of the Code provides that "In General, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable years in carrying on any trade or business, including--

"(1) a reasonable allowance for salaries or other compensation for personal services actually rendered;

"(2) traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; * * *

Section 212 of the Code which relates to personal, living, and family expenses provides that in computing taxable income, no deduction shall be allowed, except as otherwise expressly provided in Chapter 1 of the Code for personal, living, and family expenses.

Teachers may deduct dues to professional societies, subscriptions for educational journals, and expenses of traveling and meals and lodging incurred in attending teachers' conventions in this country, if they are not reimbursed for these expenses. Records must be kept to substantiate the deductions. Cost of professional books purchased for use in connection with their professional work is a depreciable c pital expenditure. The cost of university robes and gowns and laboratory coats

Exhibit A (Continued

Professor Kenneth F. Byrd

may be deducted.

Travel expenses incurred by teachers on sabbatical leave from their schools, who receive compensation while on leave may deduct (Sic) their travel expenses if the travel was required by the school board and if they are required to report to the school relative to their travel. These expenses are not deductible if the travel and study are not required by the school in order to maintain the position.

The cost of clerical assistance is deductible if the professor can show that the assistance is necessary and that the expense is not paid by his employer. If a professor is provided an office or office space, it would be a rare instance when an office in his residence would also be required. In general, if the university provides an office the expense of an office in a professor's residence would be disallowed in the examinationn of a return on which the deduction was claimed.

Section 1.162-5 of the income tax regulations provides that "(a) Expenditures made by a taxpayer for his education are deductible if they are for education(including research activities) undertaken primarily for the purpose of:

"(1) Maintaining or improving skills required by the taxpayer in his employment or other trade or business, or

"(2) Meeting the express requirements of a taxpayer's employer, or the requirements of applicable law or regulations, imposed as a condition to the retention by the taxpayer of his salary, status, or employment".

Whether or not education is of the type referred to in subparagraph (1) above shall be determined upon the basis of all the facts of each case. If it is customary for other established members of the taxpayer's trade or business to undertake such education the taxpayer will ordinarily be considered to have undertaken this education for the purpose described in (1) of the paragraph. Expenses for education described in (2) are deductible only to the extent that they are for the minimum education required by the employer, or by applicable law

Exhibit A (continued)

- 3 -

Professor Kenneth F. Byrd

or regulations, as a condition to the retention of the taxpayer's salary, status, or employment.

Expenditures made by a professor for his education are not deductible if they are for the purpose of obtaining a new position or substantial advancement in position, or primarily for the purpose of fulfilling the general educatio aspirations or other personal purposes of the taxpayer.

We are enclosing some pamphlets which may be of value to you.

Very truly yours,

C. I. Fox

Director of International Operations.

EXHIBIT "B"

AIRMAIL

Inland Revenue
Chief Inspector
Taxes Branch
New Wing, Somerset House
London, W.C. 2

Kenneth F. Byrd, Esq.
Professor of Accounting
McGill University
Montreal 2, P. Q.

10 December, 1962

Dear Sir:

I have your letter of 22nd November, 1962. It covers a wide field but I trust the following information will assist you.

Professors and lecturers at universities hold offices or employments, the income from which is assessable in the United Kingdom under Schedule E. To be admissible as a deduction in arriving at the emoluments assessable under this Schedule an expense must come within paragraph 7 of the Ninth Schedule, I.T.A. 1952 which reads as follows:-

> "If the holder of any office or employment of profit is necessarily obliged to incur and defray out of the emoluments thereof the expenses of travelling in the performance of the duties of the office or employment, or of keeping and maintaining a horse to enable him to perform the same, or otherwise to expend money wholly, exclusively and necessarily in the performance of the said duties, there may be deducted from the emoluments to be assessed the expenses so necessarily incurred and defrayed".

In brief, before a man can claim an expense as a deduction he must show that he is necessarily obliged to incur it and that it is incurred in the performance of his duties. The scope for deductions is, therefore, very limited and the Courts have consistently supported a strict interpretation of the terms of the paragraph.

However, it is recognized that if a university teacher is to fulfil his duties adequately he may incur expenditure in respect of which a claim under paragraph 7 is justified. I think the points to which you specifically

Exhibit B (continued)

-2-

Chief Inspector of Taxes Branch (Continued)

refer are all covered in the summary below which sets out our normal approach to university teachers.

(1) Robes and Gowns
Where the wearing of these is customary the cost of maintaining and replacing them, but not the initial cost of providing them, would be allowed.

(2) Laboratory Coats
If the university did not supply these itself, the cost of maintenance and replacement would be allowed to teachers whose duties necessitate their use.

(3) Study Allowance
Where the facilities provided by the university are inadequate and it is necessary for the teacher to use a room at his residence in the performance of his duties a reasonable deduction is allowed for rent, or annual value, and rates applicable to the part of the residence so used and for the incidental cost of lighting, heating and cleaning, etc.

(4) Research
It is recognized that university teachers are normally under some obligation to engage in research in their subjects, but the nature and extent of the research is within the discretion of the individual teacher. Where there is an obligation to engage in research we are prepared to agree deductions in principle for research expenses which are directly related to the teacher's subject, and are moderate in amount, and in respect of which reimbursement is not available.

(5) Books
No deduction is allowed for depreciation of a teacher's library as such, but one may be allowed in respect of purchases where it is clear that the books are used by the teacher in the performance of his duties (i.e. if they are used in the preparation

Exhibit B (Continued)

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Chief Inspector of Taxes Branch (Continued)

of lectures or in the course of research). No deduction is allowed for expenditure on books which is in the nature of capital outlay or which is incurred for the general maintenance of teachers' knowledge and qualifications. Where a deduction is allowed it is restricted to the cost of the books less their secondhand value.

(6) Summer Schools, Refresher Course, etc.

Expenses incurred to maintain professional competence and to keep abreast of current trends of thought are outside the scope of paragraph 7; therefore, the expenses of attending summer schools, refresher courses, meetings of learned societies, conferences, etc. are normally inadmissible. Where a teacher attends a conference in an official capacity, e.g. to read a paper, his expenses are usually reimbursed.

(7) Clerical Expenses

The expense of clerical assistance would not normally be regarded as necessarily incurred in the performance of a university teacher's duties; some deduction might be allowed under (4) above - Research - for the typing of articles for publication, etc.

(8) Subscriptions for Learned Societies

Where the activities of a Society are relevant to the teacher's office or employment a deduction may be given under Section 16, Finance Act 1958 in respect of subscriptions to it provided the Society has been approved by the Board of Inland Revenue for the purposes of the Section. Frequently a subscription entitles the member to copies of the Society's periodicals and bulletins.

(9) Sabbatical Leave

It is a little difficult to generalize on the expenses incurred by a professor on sabbatical leave or undertaking

Exhibit B (continued)

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Chief Inspector of Taxes Branch (Continued)

summer school lecturing as no doubt the terms on which they are engaged vary. Any expense in respect of such work could not be deducted from the income of his main post, but if in effect he took a separate one the income from which is assessable Schedule E, then again he could deduct from the emoluments of that post those expenses within paragraph 7. The cost of travelling between his main place of work and the other university would not be admissible nor would the cost of living away from home.

Generally, the view is taken that the salary of a university teacher is his remuneration for the work he does. It is more or less standardized without regard to possible variations in expenditure and it is, therefore, a reasonable inference that an individual teacher is not expected to use a substantial part of his salary to pay for research, books, etc. Expenditure which is not modest in amount, therefore, is considered to be not necessarily incurred and not within paragraph 7.

Of course, in addition to holding offices or posts at a university many teachers exercise a profession the income of which is assessable Schedule D. For instance, many write books and articles, appear on television, speak on the radio, etc. In computing the profit from such activities, which are often carried on from the residence, teachers may be able to deduct expenses such as travelling etc. which would not satisfy the stringent terms of paragraph 7 and could not, therefore, be deducted from their salary as university teachers.

Yours faithfully,

(Sgd.) R. W. Roe

Senior Principal Inspector of Taxes

APPENDIX "M"

NAME: CANADIAN ASSOCIATION OF UNIVERSITY TEACHERS

SUBJECT: Deduction of Employment Expenses and Taxation of Fellowships, Scholarships, Bursaries and Research Grants.

Analysis of Appendix "L" by Senior Advisor

This Brief is submitted by the Canadian Association of University Teachers.

The principal points to which the brief relates are:

(1) The deduction of employment expenses. (Pages 2 to 8).

(2) Proposed taxation of fellowships, scholarships, bursaries and research grants. (Pages 8 to 11).

The brief also refers to the following subsidiary matters:

(1) The submission that University teachers should be treated as professional persons carrying on a profession for taxation purposes. (Pages 1 and 2).

(2) Pension and retirement savings contributions. (Pages 12 to 17).

(3) The taxation of visiting teachers. (Page 11).

Recommendations of the brief are not summarized, but are made under the subject headings referred to above.

The usual summary of present tax laws, White Paper proposals and principal points of the brief is attached.

Name : CANADIAN ASSOCIATION OF UNIVERSITY TEACHERS

Date Brief Received:

Principal Subject: Deductions for Employment Expenses

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 5-2 of the Income Tax Act This section permits construction workers under specified conditions to deduct living and travelling expenses from employment income. Section 11-1-q of the Income Tax Act This section permits clergymen under specified conditions to deduct certain living costs. Section 11-5 of the Income Tax Act This section permits relieving telegraphers and station agents to deduct under specified conditions certain expenses from employment income.	The proposals of the White Paper respecting employment expenses are contained in the following paragraphs: 1.32 The government has examined the deductions individuals may claim for various costs they incur, as well as differences in treatment between taxpayers who are employed and those who carry on a business or profession. The royal commission said many employees have been over-taxed because they have been denied the deduction of almost all expenses incurred in earning wages and salaries. But millions of taxpayers are involved, and a very wide range of expenses could be related to earning their employment income. These taxpayers do not keep detailed records. The government has found no practical way to permit employees to deduct actual costs as do those carrying on a profession or other business. We propose to provide employees with a general deduction to cover expenses, in addition to certain specified deductions. The amount would be 3 per cent of employment income, up to a total of $150 a year. This could benefit more than 6,500,000 persons, the great majority of them earning less than $10,000 a year.	Paragraphs 7, 10, 12, 13, 14, 15, 19 and 20 of the Brief This portion of the brief sets out: (1) The recommendations of the Royal Commission on Taxation that substantiated expenses without limit should be deductible from income without limit. (Paragraph 7). (2) The types of expenses that should be deductible. (Paragraphs 10 and 12). (3) The fact that the United Kingdom recognizes the "cost of a study" as a proper expense. (Paragraph 13). (4) The submission that convention expenses and expenses incurred in respect of summer employment should be deductible. (Paragraphs 14 and 15).

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 11-7 of the Income Tax Act This section permits transport employees to deduct under specified conditions certain expenses from employment income. Section 11-10 of the Income Tax Act This section permits employment income to be reduced by: (1) professional dues, trade union membership dues, to the extent reimbursement is not received; (2) office rent, salary of an assistant or substitute, the payment of which is required by the contract of employment; (3) cost of supplies consumed directly in the performance of the employment, the payment of which is required by the contract of employment.	2.10 The tax law permits those in business and the professions, in determining their income for tax purposes, to deduct any expense normally taken into account in determining the profit of a business, with certain specific exceptions. But the law does not permit a deduction for expenses incurred by an employee in earning wages or a salary except a few items such as union dues and travel costs incurred by a person who must travel as he performs his work. This contrast in the law has been a long-standing grievance on the part of working men. It was seriously criticized by the royal commission as unfair to employees. The commission recommended that expenses be deductible from wages or salaries just as they are from business income if "reasonably related to the earning of income." Recognizing, however, that huge numbers of employees are subject to tax and that few keep books or records to prove their expenses, the commission concluded that some means must be found to make compliance feasible for the taxpayer and administration feasible for the revenue department. They proposed offering an option to employees permitting them to claim, in place of detailed expenses, an allowance equal to 3 per cent of their gross employment income, up to a specified maximum.	(5) The fact that a "professional teaching contract" satisfies the definition of "business" in the United States. The Brief particularly recommends that: (1) University teachers should be entitled to deduct, without limit, reasonable expenses connected with university employment. (Paragraphs 7 and 20), or alternatively; (2) The meaning of "business" be amended to cover specifically the teaching and research done by a university teacher, as a faculty member of a university. (Paragraph 20).

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
No provision is made, other than as above, whereby an employee may deduct costs of travelling from his place of residence to his place of employment from employment income.	2.12 As its second measure, the government proposes to make more provision in the law for the expenses legitimately incurred in earning wages or salaries. However, it has reached the conclusion that claims for expenses on the broad basis suggested by the commission would either impose record-keeping on millions of employees or deny them the ability to submit acceptable claims. It would also produce an impossible processing task in tax administration with inevitable long delays in making refunds. Consequently the government proposes that general limits be retained on expenses that can be deducted from employment income but that a general deduction be provided and somewhat greater recognition given to special situations where employees have to live for a period of time at a work site away from home. 2.13 It is proposed to allow a general deduction for employment expenses, similar to the option proposed by the commission but with a lower maximum. The government believes these expenses are not generally as high as implied by the commission. It would be costly, and inequitable to others, to permit substantially more to be deducted by means of a formula than was normal in typical cases: Consequently it is proposed that the general deduction allowed for expenses incurred in earning employment income be 3 per cent of gross employment income up to a maximum of $150 per year.	

Name: CANADIAN ASSOCIATION OF UNIVERSITY TEACHERS

Date Brief Received:

Principal Subject: Taxation of Fellowships, Scholarships, Bursaries and Research Grants

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
The Income Tax Act provides for the taxation of grants received if they are in fact paid to an employee of the employer paying the grant, even though that employer may receive a subsidy in respect thereof. The Income Tax Act does not levy tax on grants received when the recipient is not an employee of the person making the grant, and the grant is made voluntarily.	The proposals of the White Paper respecting the taxation of Fellowships, Scholarships, Bursaries and Research Grants are contained in the following paragraphs: 1.37 It is also proposed, in fairness to other taxpayers, that fellowships, research grants, scholarships and bursaries be treated as taxable income but subject to the deduction for tuition fees and costs incurred for research. Undergraduates would seldom need to pay tax because few scholarships and bursaries are larger than the new personal exemptions plus the fees that may be deducted from students' incomes. But if students have other income, there is no reason why they should not be taxed like other Canadians. 2.24 Until now most fellowships, scholarships, bursaries and research grants not related to services have been treated as exempt from tax. There seems no valid reason for continuing such exemption. Post-graduate students and research workers are, in effect, professional workers and should pay tax as others, after allowances for tuition fees and for research expenses properly deductible from research grants. Payments to undergraduates normally fall well within the personal exemptions, after deducting tuition fees. Where they exceed exemptions or where the student has other income, he should pay tax just as other Canadians do.	Paragraph 21 of the Brief This portion of the brief states that: (1) Expenses, usually considered personal expenses, are incurred by the recipient of a grant and should be deductible from income. (Paragraph 21, page 8). (2) Grants are usually received from governments or private organizations (largely tax exempt) whose funds are limited and so are unable to pay increased grants. (Paragraph 21, page 9). (3) If grants are to become taxable, the amounts paid would have to be increased to offset the tax if the desired objectives are to be attained. (Paragraph 21, page 9).

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		(4) A premium would be placed on the pursuit of study and research abroad at the expense of Canadian studies. (Paragraph 21, page 10).
		(5) Grants for study and research offered by foreign countries are not taxed in those countries. Therefore recipients of such grants would perform study and research abroad. (Paragraph 21, page 10).
		(6) The United Kingdom treats grants as Canada does at the present time. (Paragraph 21, page 10).
		(7) If Canadian grants paid to non-residents were to be subjected to a Canadian withholding tax, this would be an additional deterrent to studies in Canada. (Paragraph 21,page 10)

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
		(8) In the United States grants received, together with amounts received to defray expenses, are exempted - (Section 117 of the Internal Revenue Code). (Paragraph 21, page 11). The Brief makes no recommendations respecting this matter.

Name : CANADIAN ASSOCIATION OF UNIVERSITY TEACHERS

Date Brief Received:

Principal Subject: Exemption from tax of Non-Resident Teachers temporarily teaching in Canada.

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Canada has entered into Income Tax agreements with a number of countries. All of these agreements except that with France, provide for the exemption of a professor or teacher from Canadian income tax for one period of up to two years on his remuneration from teaching if he has come to Canada temporarily for the purpose of teaching, and if his stay in Canada is not expected to exceed twenty-four consecutive months.	The proposals of the White Paper respecting the taxation of visiting professors and teachers are contained in the following paragraph: 2.26 Under our tax treaties with Britain, the United States and a number of other countries, professors and teachers who have come to Canada temporarily are exempt from Canadian income tax on their teaching salaries for two years. In some circumstances they are not taxed by the country where they are normally resident. Given the present scale of salaries of professors and teachers this arrangement is unjustified. We intend to remove this exemption, on a reciprocal basis, from our treaties and to tax such persons like others.	Paragraph 22 of the Brief This portion of the brief states: (1) Canada benefits from the import of new ideas and the broadening and modernizing of teaching concepts. (2) The removal of the exemption and the proposed taxation of scholarship and research grants will strengthen the impression that Canada is reversing its traditional policy of welcoming new ideas in education and encouraging Canadians to do research abroad. The Brief makes no recommendations on this subject.

Name : CANADIAN ASSOCIATION OF UNIVERSITY TEACHERS

Date Brief Received:

Principal Subject: Pension and Retirement Savings Contributions

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
Section 62-1-q of the Income Tax Act In order that a pension trust may be exempt from tax, this section requires that not less than 90% of its income be received from sources in Canada, or from bonds, debentures or other securities of certain specified organizations. No similar restrictions apply to the investment policy of Registered Retirement Savings Plans.	The proposals of the White Paper respecting Pension Plan investments and income therefrom are contained in the following paragraphs: 2.47 The government believes it desirable to encourage these personal savings plans for retirement. But it must be done on an equitable basis, available to all and subject to fair and reasonable limits. The government also believes that the tax-free trusts for retirement plans should not be entitled to the credit for corporation income tax proposed for dividends on shares in Canadian corporations. Freedom from tax on dividends and interest and capital gains should be sufficient.	Paragraph 23 of the Brief This portion of the Brief states: (1) The Teachers Insurance and Annuity Association and the College Retirement Equities Fund, being United States organizations, are not recognized as approved investments for registered retirement savings plans. (2) This will mean that the 50% tax credit for dividends on shares in Canadian companies will not be available. The brief recommends that pension funds in receipt of Canadian dividends be given the same right of tax recovery as other Canadian recipients.

Name

Date Brief Received:

Principal Subject:

Present Tax Law	Tax Reform Proposals	Principal Points of Brief
	2.52 Three other changes are also proposed. First, the savings withdrawn from these plans would be taxed at ordinary rates, even if the amounts are withdrawn at the death of the contributor. A widow would be permitted to offset or reduce this income if she contributes all or part of the proceeds to a registered retirement savings plan of her own. Second, rules are required to ensure that the trustees of a pension or retirement plan fund are liable and responsible for paying taxes arising out of its operations. This would be necessary if, for example, beneficiaries leave Canada with the assets. Third, in view of the size and rate of growth of pension and retirement savings funds, due in part to their tax-free status, it is reasonable to require that the bulk of them be productively invested in Canada. Consequently it is proposed that to qualify for the tax-free status of registered pension plans or registered retirement savings plans, these plans must invest no more than 10 per cent of their assets in foreign securities or other foreign investments.	

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